100th CONGRESS
1st Session

SENATE

REPORT
100-35

LEGISLATIVE AND OVERSIGHT ACTIVITIES DURING THE 99TH CONGRESS BY THE COMMITTEE ON SMALL BUSINESS

REPORT

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

APRIL 8 (legislative day, MARCH 30), 1987.—Ordered to be printed

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Mr. BUMPERS, from the Committee on Small Business submitted the following

REPORT

CHAPTER I. SMALL BUSINESS AND THE ECONOMY

The success of small businesses and the nation's economy are closely linked. In the last two years, a general economic recovery fostered the continued rapid growth of small businesses. Whether the good news will continue is uncertain. The GNP growth was 2.7 percent in 1985 and was 2.5 percent in 1986.

First quarter growth of 3.8 percent was followed by 0.6 percent in the second quarter. Estimates for the third quarter are higher but not enough to reassure businesses that the economy may grow weaker in the near future.

Interest rates have dropped substantially since 1984. The Federal Reserve discount rate, which started at a high of 13.41 percent in 1981, held steady at 7.5 percent through 1985. The discount rate was lowered this year to 7.0 percent in March, 6.5 percent in April, 6.0 percent in July, and 5.5 percent in August. The last year in which the discount rate was 5.5 percent was 1977. Alterations in the discount rate were intended to bolster the economy and to encourage other countries to adjust their own rates to foster worldwide economic activity. Similarly, the prime rate has experienced a decline from a high of 18.87 percent in 1981. The prime was constant at 9.5 percent in 1985 and dropped steadily to 7.5 percent in August of this year.

Inflation, as measured by the Consumer Price Index, has remained low for the last two years. According to the Bureau of Labor Statistics, inflation was 3.8 percent in 1985 and was 1.1 percent in 1986. The Producer Price index was significantly altered by the drop in oil prices.

Lower rates of inflation and lower labor cost increases, along with expanding retail sales, a strong housing industry, and falling

interest rates have combined to form a healthy environment for small businesses. Sales by small retailers increased three times as rapidly as sales by large retailers. Housing starts maintained their highest level since 1979.

There are now over 15 million small businesses in America as measured in 1985. Business starts and incorporations were active along with business closings. There were 119,065 business starts (16 percent above 1984) and 668,904 incorporations (5.3 percent above 1984) in 1985. Business failures (57,067) and bankruptcies (70,644) in 1985 were 9.6 percent and 11.5 percent respectively above the year before. With the slowdown in the economy, net income for sole proprietorships and partnerships rose only 4.9 percent during the first nine months in 1985. There is a very close linkage of net income and corporate profits to national economic activity.

Approximately 50 percent of all employment is by small businesses. Employment growth in small business grew 5.1 percent, far above the .7 percent growth in large businesses. Growth was strongest in industries where small businesses are predominant, such as construction, services, and retail trade. Employment reached a record high in 1985 of 107 million Americans. In July 1986 employment grew to 110 million.

One-person operations, have grown significantly. Unincorporated self-employment grew every year since 1970 to 7.4 million in 1984, an increase of 50 percent. Typically, the self employed are older and better educated than wage and salary workers.

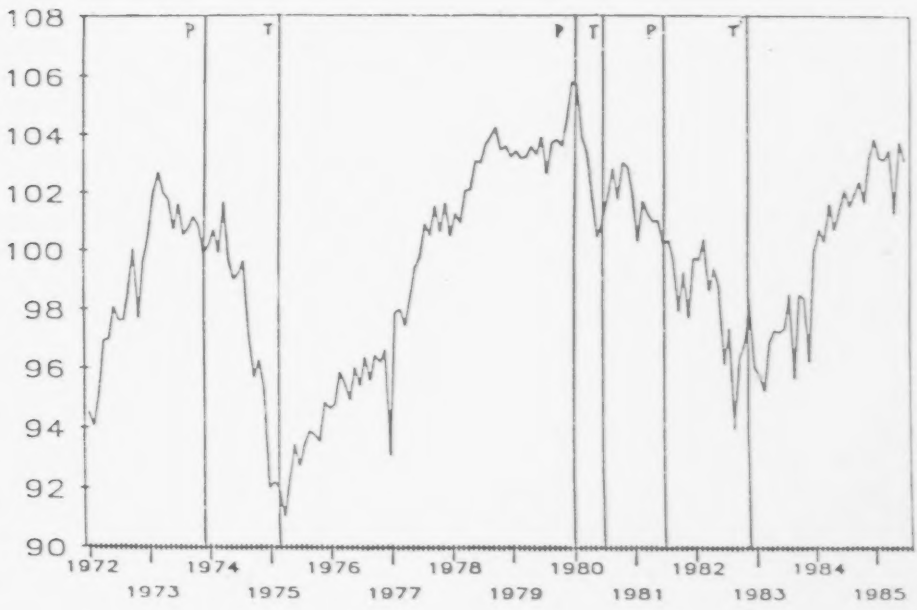
Veterans, women and minorities are presented throughout business. The SBA estimates that 3.8 million veterans were business owners in 1984. Women entrepreneurship continues to expand and has experienced a 9.4 percent annual growth rate from 1977 to 1983, currently representing 25 percent of small businesses. By the year 2000, it is anticipated that half of all small businesses will be owned by women. Minority self-employment increased from 337,000 in 1975 to 552,000 in 1985, a 64 percent increase that exceeds the rate of increase in non-minority self employment. Minority businesses are obtaining a growing share of the total procurement by federal agencies.

Small business financing and lending has increased. Thirty to 40 percent of established small businesses relied upon owner financing in 1983. Small business borrowing increased from $65 billion in 1983 to $78 billion in 1984 and declined slightly to an annual rate of $70 billion during the first three quarters in 1985. Small businesses borrowing interest rates have remained steady at 1 to 4 percentage points above the prime rate. In the use of public offerings, small business has issued most of the initial public offerings of stock (IPOs); 487 of 721 IPO issuers in 1984 had assets under $500,000.

In accordance with P.L. 96-302 (section 401), the SBA is mandated to develop small business economic indices. The Small Business Health Index was created to summarize, in a single statistic, the economic condition of small business. As shown below (Table 1), small business performance closely follows overall economic growth. Recovery from recessions and economic troughs is slow for small businesses. As the index details, performance in small busi-

ness has been good (and continues into late 1986) when a generally healthy economic environment is maintained.

TABLE 1 Small Business Health Index: 1st Quarter 1972 through 2nd Quarter 1985.



SOURCE: U.S. Small Business Administration, Office of Advocacy

NOTE: Vertical bars labeled "P" and "T" represent peaks and troughs, respectively, in macroeconomic business cycles.

Small business and the economy have generally prospered since 1984, but doubts about the continued growth of the economy have resulted in widespread concern and hesitancy in planning expansions and capital projects. Small businesses have become a predominant force in business growth, economic activity, and employment of the American work force.

Chapter II. The Small Business Administration

The principal legislative jurisdiction of the Senate Committee on Small Business is over the Small Business Administration (SBA) and its programs. Historically, the Committee has exercised its authority to evaluate the programs of the SBA to ensure that those programs have met the needs of the nation's 15 million small businesses. When legislative reforms were appropriate, the Committee worked to modify programs to meet the needs of the small business community. During the 96th and 97th Congresses, for example, the Committee worked closely with the Administration to improve programs and policies to make the SBA more responsive to the needs of small businesses and to make it a stronger, more cost-effective

agency. During the 99th Congress, however, the Committee's attention was focused on fighting back the wholesale attempt by the Administration to eliminate the SBA as an independent agency including its important financial, managerial and procurement assistance programs. Through the budget reconciliation process, Chairman Lowell Weicker, Jr. and Ranking Member Dale Bumpers, with equal support from the House Committee, were able to win the enactment of legislation to provide for a three-year reauthorization of the SBA. By working closely with the Appropriations Committee, the Small Business Committee was able to maintain adequate funding for most of the agency's programs and activities, while at the same time achieving federal budget savings of $2.5 billion in FY 1986–88.

The President's FY 1986 budget proposal

The President's budget for FY 1986 included a proposal which, if enacted, would have eliminated the Small Business Administration (SBA) as an independent executive agency. It would have terminated all SBA financial programs and transferred the existing SBA loan portfolio to the Treasury Department for liquidation, terminated all but a few of the SBA's small business management assistance programs, and transferred to the Department of Commerce the remaining SBA programs to be merged with the Commerce Department's Minority Business Development Agency (MBDA), forming a new Enterprise Development and Opportunity Administration.

SBA programs slated by the Administration for transfer to the Department of Commerce would have included the Office of the Chief Counsel for Advocacy, the Office of Procurement and Technical Assistance, the Office of Innovation, Research and Technology, the Office of Minority Small Business and Capital Ownership Development, and the Service Corps of Retired Executives (SCORE) and Active Corps of Executives (ACE) management assistance programs. In FY 1986, this new Commerce office would have had an operating budget of $52 million with 703 full-time employees, as compared to approximately 4200 full-time employees at SBA currently.

The Administration's proposal called for the termination of all direct and guaranteed business loans, effective October 1, 1986. Further, the Administration proposed to eliminate all disaster loans to homeowners and businesses devastated by natural disasters. Over the past year, SBA has provided about 23,000 disaster loans, totalling $7,000 to cover uninsured losses caused by floods, tornadoes, hurricanes or other physical disasters.

Finally, the Administration's proposal would have terminated almost all of the SBA's management assistance and special outreach programs. The small business management assistance programs slated for elimination included the Small Business Development Centers (SBDCs) and Small Business Institutes (SBIs), as well as the SBA management assistance representatives located at the 119 SBA field offices. The SBA "special programs" slated for elimination were the Office of Women's Business Ownership, the Office of Private Sector Initiatives, and the Office of Veterans Affairs.

The Administration maintained that these programs "duplicate private sector activities" as well as those being transferred to the Department of Commerce.

S. 408

Chairman Weicker and Senator Bumpers' response to the Administration's proposal was the drafting and introduction of S. 408, which reauthorized SBA as an independent agency for FY 1986–1988. Rather than dismantling SBA as an independent agency, S. 408, as introduced, would have achieved almost $800 million in budget savings through a freeze of program levels in FY 1986 at the FY 1985 levels, and through certain other program reductions and eliminations. Specifically, the bill proposed:

(1) Eliminating the SBA direct lending program, with the exception of loans to the handicapped ($20 million), Vietnam-era or disabled veterans ($25 million), and Minority Enterprise Small Business Investment Companies (MESBICs) ($41 million). Thus, the SBA's direct lending program level would have been reduced from $257 million to $86 million in FY 1986. This resulted in a savings of $171 million in budget authority in FY 1986.

(2) Eliminating the non-physical disaster loan program, which was authorized at $100 million annually.

In FY 1986, the SBA loan program authorized by S. 408, along with the Surety Bond guaranty and the Pollution Control Equipment Contract Guaranty Program were all frozen at FY 1985 levels. The salaries and expenses portion of the budget was reduced by $24 million in outlays for FY 1986.

In FY 1987 and 1988, S. 408 would have adjusted all program levels and the salaries and expenses account for inflation.

According to CBO, S. 408 as introduced would have saved $661 million in budget authority and $726 million in outlays over FY 1986–1987.

The Committee conducted three days of legislative hearings on S. 408 on February 21, 28, and March 7, 1985.

On February 21, 1985, the Committee received testimony from four small business owners and executives, from banking officials, and from the president and chief executive officer of the National Federation of Independent Businesses. All of these witnesses attested to the important financial services provided by the SBA to the small business community and urged the Committee to maintain funding for the SBA-guaranteed lending programs. Furthermore, all the witnesses stressed the importance of maintaining the SBA as an independent agency and advocate for small business.

On February 27, 1985, in a letter to Chairman Domenici and Ranking Member Chiles of the Senate Budget Committee on the Small Business Committee's views on the President's FY 1986 budget proposal, Senators Weicker and Bumpers wrote:

> We want to assure you that our Committee is prepared to scrutinize every program in the Small Business Administration and to make the necessary program changes in order to meet our responsibility toward deficit reduction. At the same time, however, we want to emphasize in the strongest possible terms our belief that the Administra-

tion's suggestion that SBA be abolished is short-sighted, irresponsible and unacceptable.

The Committee's hearings on S. 408 continued on February 28, 1985, when the Committee heard from more small business owners who credited their survival and success to the financial and other assistance they received from SBA. The SBA Administrator James Sanders testified in support of the Administration's proposal and responded to questions from the Committee on many of the reforms made at the SBA during his tenure. David Stockman, Director of the Office of Management and Budget (OMB), and the principal spokesperson for the President's budget presented the Administration's proposal and worked for its adoption by Congress.

On March 7, 1985, the Committee concluded its hearings by receiving testimony from the Honorable Marlene Johnson, Lieutenant Governor of the State of Minnesota, concerning the substantial benefits that the SBA and its programs had on the small business community in that state. The Committee also received testimony from the Mayor of Springfield, Illinois, on behalf of the United States Conference of Mayors, and from the Mayor of Warner Robins, Georgia. Both described the importance of SBA's financing programs to economic growth, in particular the Section 503 Certified Development Company program. Also testifying in support of S. 408 were representatives of the National Association of Small Business Investment Companies, the American Association of Minority Enterprise Small Business Investment Companies, Small Business United, the Small Business Association of New England, the Small Business Legislative Council, the U.S. Chamber of Commerce, the Small Business Service Bureau, and the Association of Small Business Development Centers. Representatives of these organizations were united in their opposition to the Administration's proposal to terminate the SBA and each attested to the need for the essential services provided by the SBA and its programs.

On March 26, 1985, the Committee met in executive session to consider S. 408. As the basis for its consideration, the panel used a Committee print which incorporated the text of S. 408 and two new policy changes in the SBA loan guarantee program recommended by Senators Weicker and Bumpers. These two new proposals were based on testimony and recommendations received by the Committee and on the panel's assessment that additional savings could be achieved without harm to the program. The proposal included an increase in the guaranty fee charged to borrowers in the 7(a) guaranteed lending program from one percent to two percent for loans which exceed one year, and a reduction from 90 percent to 80 percent of the maximum SBA guaranteed portion of loans. According to the Congressional Budget Office (CBO), the total savings achieved by enacting S. 408, as amended, would have been $1.114 billion in budget authority and $865 million in outlays over a three-year period.

The Committee, by a vote of 16–3, agreed to favorably report the bill, as amended. Prior to that vote, the Committee rejected, by a vote of 15–4, an amendment offered by Senators Boschwitz and Gorton, which would have: (1) eliminated direct loans for veterans and handicapped and provided in their place targeted guaranteed

loan authority of $30 million annually for each; (2) reduced the general business loan guarantee program from $2.7 billion to $2.0 billion; and (3) eliminated funding for Small Business Investment Companies (SBICs) and Section 503 Certified Development Companies through the Federal Financing Bank and required these programs to obtain funding with the SBA guarantee through private capital markets. Following that vote, the Committee adopted an amendment offered by Senator Levin, to require the SBA to utilize the full program authority subject to certain limitations. An amendment was offered by Senator Harkin to establish an annual sales size standard of $500,000 for agricultural enterprises and to prohibit discrimination against agricultural enterprises.

The Harkin amendment was withdrawn upon receiving assurance from the Chairman that he would request an expedited review by the SBA of its current size standards for agricultural enterprises. Senator Weicker also offered and withdrew an amendment that would have repealed certain provisions of P.L. 98–270, which lowered disaster interest rates at the SBA. Senator Weicker stated his intention to offer the amendment during Senate floor consideration pending a review of how the FmHA and the SBA administer their respective disaster assistance programs. Committee Members sought assurance that farmers and businesses would receive fair and equitable treatment by the agencies involved.

During full Senate consideration of the First Concurrent Budget Resolution, S. Con. Res. 32, a compromise agreement was reached among the Chairman of the Committee, the Senate Republican leadership and the Administration which maintained funding for SBA as an independent agency while achieving $2.5 billion of outlay savings over three Fiscal Years. This compromise was adopted by the Senate as a part of the Budget resolution which passed the Senate by a vote of 50–49. Later, that compromise was incorporated by amendments to S. 408 which passed the Senate on July 16, 1985, by a vote of 94–3.

S. 408 was not considered separately by the House of Representatives. The Committee did, however, report S. 408, with the additions made by the Weicker compromise, as the Committee's compliance to its reconciliation instruction. Finally, the budget reconciliation conference agreement reached with the House Committee Conferees on H.R. 3128, the Omnibus Reconciliation Act of 1985, largely tracked the terms of the compromise reached by the Chairman, Senate Leadership and the Administration. Also, the State, Justice, Commerce Appropriations Act for FY 1986, Public Law 99–180, provided funding for SBA programs at levels close to those reached in the agreement.

Even though conferees on other titles of the Consolidated Omnibus Budget Reconciliation Act of 1985 were unable to reach agreement on the bill, by the end of the first session of the 99th Congress the House and Senate Small Business Committees conferees did reach an agreement on the small business provisions of the bill. Among other things they agreed to:

Retain SBA as an independent agency with all of its core of financial, management and procurement assistance programs intact.

Maintain the existing loan portfolio for normal collection.

Eliminate all direct loans except for economic opportunity, MESBICs, handicapped assistance loans and Vietnam-era veterans loan programs, and freeze those programs at the FY 1986 appropriated levels.

Eliminate farmers' eligibility for SBA disaster loan assistance, for disasters declared after September 30, 1986.

Require Small Business Investment Companies to sell their debentures, with SBA's endorsement, in the private capital markets rather than to the Federal Financing Bank.

Establish a pilot program for sale of Section 503 Certified Development Company debentures to be sold to the private capital markets by FY 1988.

Maintain guarantee loan programs at current services levels.

Increase the guaranty fee for 7(a) borrowers from one to two percent and set the maximum guarantee for loans over $155,000 at 85 percent, and for loans under $155,000 at 85 percent, and for loans under $155,000 require a 90 percent guaranty.

Maintain salaries and expenses at the current services levels.

Final resolution of the 1985 reconciliation measure was not reached until the second session of the 99th Congress. On April 7, 1986, President Reagan signed Public Law 99-272, the Combined Omnibus Reconciliation Act of 1985 (COBRA). Title 18 of this law included the three-year reauthorization of SBA through FY 1988.

The President's FY 1987 Budget Proposal

Even though final enactment of the three-year compromise contained in the Conference Agreement on H.R. 3128 was still pending in Congress, the President's 1987 budget proposal submitted to the Congress on February 5, 1986, again proposed the elimination of the SBA as an independent agency. Instead of proposing the creation of a new entity in the Department of Commerce, this proposal was to transfer the SBA into Commerce with the Administrator of SBA becoming an Undersecretary of Commerce. This budget plan also proposed the elimination of all SBA credit programs, and the transfer of the Agency's loan portfolio to the Department of Treasury for sale and liquidation. Although many of the activities contained in the previous year's proposal would again have been continued, the 1987 budget also proposed that Procurement Center Representatives (PCRs) also be eliminated.

In the previous year, Senators Weicker and Bumpers, expressing their views on the President's budget, wrote to the Chairman and Ranking Member of the Senate Budget Committee stating their opposition to the President's budget proposal for FY 1987. Noting that it was essentially the same proposal that the Congress had debated the previous year, they stated:

> We oppose in the strongest terms the President's fiscal 1987 Budget proposal for SBA, just as we opposed the same proposal for FY 1986. We believe it is shortsighted, irresponsible and unacceptable, both as a means of deficit reduction and as an expression of national policy toward small business. It ignores SBA's role and contribution in maintaining a viable and progressive small business sector and creating an economic climate conducive to individual

> initiative and opportunity. It also breaches, in our view, the compromise agreement reached last year among the Chairman of this Committee, the Senate Republican Leadership and the Administration regarding the future of the SBA.

On March 24, 1986, the Senate Budget Committee reported to the Senate its recommendations in the budget resolution for FY 1987, S. Con. Res. 120. In its recommendations the Budget Committee "started with the proposals of the Small Business Committee. The resolution did not assume the transfer of SBA to the Commerce Department or the elimination of its business loan program." (Senate Budget Committee Report of S. Con. Res. 120) The resolution assumed the continuation of SBA direct loans for minorities, veterans, and the handicapped at the FY 1986 level of $97 million; it also assumed the financing reforms for the SBIC and Section 503 programs which were contained in the 1985 reconciliation measure, which had not yet been enacted into law.

In addition to the proposals contained in the Small Business Committee's recommendations, the resolution assumed additional changes in SBA programs which the Budget Committee labeled "lending reforms". These reforms proposed that the SBA loan guarantee program would become self-supporting beginning in FY 1987. According to the Budget Committee report "self-supporting" meant that the guarantee program would have to cover administrative and default expenses on loans guaranteed starting in FY 1987. The Budget Committee also assumed the sale of $200 million a year in SBA business loans, in keeping with the Administration's proposal to test loan sales as a portfolio management device. Further, the Budget Committee called for the elimination of the SBA disaster loan program and the sale of the $3.3 billion disaster loan portfolio over a three-year period. Finally, the Budget resolution included reconciliation instructions to the Senate Small Business Committee which required the Committee to achieve $856 million in outlay savings over three Fiscal Years.

Responding to the Budget Committee's proposal to make the guarantee lending programs self-supporting, Senators Weicker and Bumpers wrote to Budget Committee Chairman Domenici:

> According to the best information available, to achieve your objective of having guaranteed loans be "self-supporting" a fee in the range of 7 percent or more would have to be imposed on small business borrowers. In response to our Committee's inquiries last year, SBA indicated that a 5 percent fee coupled with a reduction in the percentage guarantee to 70 percent would still cost the government 3 to 4 cents for each dollar of a guaranteed loan. Therefore, to reduce the cost to zero as you propose, the fees and percentage guarantee would have to be set at levels that would render the program useless to both small business borrowers and lenders.

The letter also raised concerns about the elimination of the disaster loan program and the sale of loan assets at bargain basement prices.

On April 30, 1986 during the full Senate consideration of the Budget Resolution for FY 1987, S. Con. Res. 120, Senator Weicker in a colloquy with Senator Domenici again expressed the Committee's strong opposition to the assumption in the resolution that SBA guarantee loans be made self-supporting beginning immediately in FY 1987. In the colloquy Senator Weicker stated:

> In my judgment, requiring a self-supporting guaranteed program in FY 1987 will effectively terminate the 7(a) program. This program was the primary target of former OMB Director Stockman's attack on SBA. Maintaining the 7(a) program, which is an important source of long-term capital for small businesses, was an integral part of our 3-year agreement. . . Such changes would fundamentally alter the purpose of the program. Before making additional changes, we should wait to evaluate the impact of the reforms just enacted.

The position of Senator Weicker was buttressed by letters from the American Bankers Association, National Association of Government Guaranteed Lenders, the Money Store and Merrill Lynch which were all inserted in the *Congressional Record.* Senator Domenici responded that the assumptions in the budget resolution were not binding on the Small Business Committee, as long as the Committee found another way to meet its reconciliation instructions. Senator Weicker thus presented an alternative proposal to meet the instruction by financing the 503 program completely by sales to the private marketplace, selling slightly more loans under a pilot loan program and raising the fee on 7(a) loans by one-quarter of a percent. Senator Domenici explained that he had proposed the self-supporting concept as a way to preserve SBA business assistance, but that he did not intend to pursue it any further. On May 2, 1986, the Senate once again rejected the President's proposal for the SBA by approving a Budget Resolution which maintained SBA as an independent agency, tracking very closely the Combined Omnibus Budget Reconciliation Act of 1985, Public Law 99–272.

Shortly before the President's signing of P.L. 99–272 on April 7, 1986, the recently appointed Deputy Administrator Charles Heatherly became the Acting Administrator, following the retirement of James Sanders as the Administrator of SBA. Upon taking the position, Mr. Heatherly made it known that his priority would be to pursue the President's FY 1987 budget in spite of the President's approval of the three-year reauthorization of the Agency. In his first week on the job Mr. Heatherly fired six of the ten SBA regional administrators. According to press accounts, Mr. Heatherly took this precipitous action in order to place his own people on the job so he could press forward the President's proposal. Although the Administration's budget proposal for FY 1987 proposed elimination of SBA core programs, closing down field offices and the sale of the agency's loan portfolio, the Committee viewed the enactment of P.L. 99–272 as the final decision on the future of the Small Business Administration as an independent agency.

On April 28, 1986, Chairman Weicker held a hearing to examine the Administration's plans for implementing the recently enacted law. The only witness to testify at that hearing was the Acting Ad-

ministrator, Charles Heatherly. Members of the Committee carefully reviewed the Acting Administrator's plans for faithfully executing the recently enacted law, and made clear that, with the enactment of the reconciliation bill, they considered the debate over the future of the SBA resolved. Senators of both parties emphasized that the Committee would not allow SBA to be dismantled administratively. Following that hearing, the Committee monitored closely the actions of the Acting Administrator to insure that the law was fully implemented. At the urging of Senator Kerry, the Acting Administrator agreed to reassess his stated intention not to exercise SBA's pooling authority for the SBIC program and, eventually, Mr. Heatherly did agree to implement this crucial provision.

On May 8, 1986, a resolution was introduced by Senator Sasser urging the President to submit a nomination for the position of SBA Administrator, and on June 25, 1986, an original Committee resolution, S. Res. 434, was reported to the Senate which had a similar effect.

During the White House Conference on Small Business held in August 1986 in Washington, the White House announced to more than 1,800 delegates at the Conference that the President intended to send to the Senate a nominee to be the permanent Administrator. Following the conference, the acting administrator was quoted by the press as stating that the Administration would no longer pursue its efforts to transfer the SBA to the Department of Commerce. Unfortunately, the President did not submit a nominee to the Senate before the adjournment of the 99th Congress.

In June 1986, the House and Senate Budget Committee Conferees agreed on a Budget Resolution, S. Con. Res. 120. The resolution including instructions to the Senate and House Small Business Committees to report legislation achieving $412 million in outlay savings in three fiscal years. The budget resolution assumed that these savings would be achieved by the sale of the SBA disaster loan portfolio over four years, approximatly $1 billion in face value would be sold each year. The resolution also assumed that the SBA disaster loan program would continue through 1989 at currect program levels. The SBA disaster loan sale was one of several proposals to sell loans assumed in the Budget Resolution.

On July 24, 1986, the Small Business Committee met and reported its reconciliation recommendations to the Senate Budget Committee. The Small Business Committee rejected the policy assumption in the resolution to sell the disaster loan portfolio for three principal reasons. First, the Committee believe it made little sense to sell the entire portfolio while at the same time continuing the program. According to the SBA and the Congressional Budget Office, such action would have required the Congress to appropriate approximately $450 million in FY 1988 and $600 million in FY 1989 to replenish the disaster loan revolving fund in order to keep the program running. Secondly, the Committee was concerned that the sale of disaster loans without recourse or a Federal guarantee, as was contemplated by the Budget Committee, would result in very deep discounts from face value. According to estimates available to the Committee, the best estimate was that the portfolio would sell for about 38 cents for every dollar on the face value on the loan. Indeed, some investment banking firms informed the

Committee that without a guarantee the portfolio would have to be sold at fire sale prices, if it could be sold at all. Further, the Committee was very concerned that the sale of these loans to private investors without recourse would mean that homeowners, businesses and farmers who have been the recipients of SBA disaster assistance would have no protections and would be subject to immediate foreclosures in the event of defaults. Given the state of the farm economy, the Committee believed this would be particulary harsh for farmers. According to SBA, only 70 percent of the farm loans in the portfolio were current.

Instead of the sale of disaster loans, the Committee recommended legislation calling for the Secretary of the Treasury to sell Section 503 Certified Development Company loans held by the Federal Financing Bank. The Committee concluded that these loans were among the best quality loans made by the SBA and would therefore bring a better price. Because the 503 loans are highly collateralized and have shown a very high currency rate, the Committee was advised that they could sell for a premium above face value if sold with recourse. As the Committee report stated:

> The Administration estimates that if sold on a non-recourse basis Section 503 loans would get about 49 cents for every dollar of face value. CBO estimates the portfolio could sell for as much as 60–70 cents. One investment banking firm estimated that the portfolio could sell for up to 83 cents on the dollar. By contrast, if sold with recourse to the Federal government, which implies that the investor assumes virtually no risk of non-payment, the portfolio would sell at a premium above face value since the average yield is some 200 to 300 basis points above comparable market yields. Consequently, the government would expect to make a "profit" by selling the loans for $1.12 to $1.13 on the dollar.

Thus, the Committee concluded the sale of loans should be with recourse to the government, thereby providing revenues to the Treasury and reducing the deficit. Senators Weicker and Bumpers wrote to Senators Domenici and Chiles and argued that the sale of loans on a basis other than with recourse would waste valuable assets and add to the deficits. Thus, the Committee proposed that the Secretary of the Treasury sell sufficient Section 503 debentures with a 100 percent guarantee in order to net proceeds to the federal government of $361 million in 1987, $55 million in 1988, and $14 million in 1989. The Committee voted unanimously to submit these legislative changes to the Senate Budget Committee.

In providing a cost estimate of the Committee proposal, however, CBO did not score the proposal as producing any off-setting receipts or cost savings. The rationale provided by the CBO was as follows:

> Unlike the sale of assets without a federal guarantee, CBO and OMB consider loans sold with federal guarantees, as a form of borrowing by the federal government. Because receipts from federal borrowing do not affect the deficit, the proceeds of the sale are not shown as a deficit reduc-

> tion in the year received. The cash proceeds, however, reduce the need for regular Treasury market borrowing. Interest costs, on balance, would be higher because the foregone interest on the loans exceeds the amount saved on regular, lower-cost Treasury borrowing.

During full Senate consideration of S. 2706, the Reconciliation Act of 1986, Senators Domenici and Chiles offered an amendment to the Small Business Committee provisions of the Act under Title IX which modified the Committee provisions to require that the Secretary of the Treasury sell Section 503 loans without recourse to the government. Opposing the amendment and explaining the reasons for the Committee's actions, Senator Weicker challenged the technical scoring by CBO stating:

> According to the OMB and CBO, the sale of loans with recourse to the government should not be scored as providing budget savings because such sales create another form of borrowing. They argue that because loans sold with a federal guarantee of timely payment of principle and interest, i.e. with full recourse, have a contingent liability that the government may have to honor at some point in time, none of the proceeds from such sales should be counted. That argument ignores the economic reality that from the sale of an asset the government collects cash which can be applied to reduce the deficit and the practical reality that most federal loan programs have historical loss rates which make the losses in these programs somewhat predictable . . . I recognize that a liability still exists on loans sold with a guarantee and that there will be losses. But I reject the notion that no savings are achieved. Rather than ignore the proceeds from the sale, sound public policy would dictate that we take notice of the historical loss rate of the program and provide a certain amount from the sale to cover losses.

Chairman Weicker argued that selling loans without recourse was not realistic and in the government's best interest. The Senate, however, adopted the Domenici/Chiles amendment for loans sales without recourse. On September 20, 1986, S. 2706 passed the Senate and was later incorporated in H.R. 5300, the House-passed reconciliation bill.

As its proposal to meet the budget reconciliation instructions, the House Small Business Committee reported a measure to create a Corporation for Small Business Investment (COSBI), a government-chartered corporation which would manage and fund the SBIC and MESBIC programs. An integral part of this proposal called for COSBI to purchase SBIC debentures held by the Federal Financing Bank. Under the House-passed bill, the Secretary of the Treasury would have been directed to sell to COSBI the portfolio of SBIC debentures, with the 100 percent SBA guarantee. Under H.R. 5300, this proposal was scored by CBO as producing costs savings.

On September 24, 1986, the House and Senate Conferees on the Small Business Committees met to resolve differences under Title IX of the reconciliation bill. After strong objections were raised by

the Secretary of the Treasury and the Director of the Office of Management and Budget to the COSBI proposal, the House and Senate conferees were unable to agree. Thus, no provisions from Title IX were included in the final conference report on H.R. 5300.

Corporation for Small Business Investment (COSBI)

On July 16, 1986, Senators Weicker and Bumpers introduced S. 2647, legislation to create a federally chartered, privately owned corporation which would relieve the Federal government of the need to provide funds or loan guarantees annually for Small Business Investment Companies (SBICs) and Minority Enterprise Small Business Investment Companies (MESBICs). The new entity to be known as the Corporation for Small Business Investment (COSBI), would issue non-government guaranteed securities to finance SBICs and MESBICs, similar to other government-sponsored enterprises such as the Student Loan Marketing Association and the Federal National Mortgage Association.

This proposal was similar to an earlier version of the concept introduced by Senator Weicker in 1984, as S. 2686. However, S. 2647 made significant improvements over the previous bill. It clarified that COSBI would pay in cash for the entire outstanding portfolio of SBIC debentures currently owned by the Federal Financing Bank which amounted to about $1 billion. As purchased by COSBI, those debentures would have carried a government guarantee to facilitate COSBI's ability to raise capital by using the portfolio as an asset base. The bill also clarified that, in the event that COSBI fell on hard financial times, the Secretary of the Treasury could purchase up to $500 million in COSBI securities to shore up the Corporation. This purchase by Treasury could occur only upon an express appropriation by Congress. An earlier version of COSBI would have given the Treasury Secretary unbridled discretion to purchase up to $1 billion in COSBI securities. Finally, S. 2647 provided for a continuing role for the SBA in supervising COSBI. S. 2647 was identical to a version of the bill that had been introduced in the House of Representatives by Congressman Parren Mitchell and several other House Members.

On August 7, 1986, the Committee held a hearing on S. 2647. The day before the hearing, the Chairman received a letter from OMB Director James Miller, setting forth the Administration's opposition to all government-sponsored enterprises. Appearing as a witness for the Administration was Robert A. Turnbull, Associate Deputy Administrator for Management and Administration at the Small Business Administration, who explained in great detail OMB's objections to the bill. Other witnesses at the hearing were Mary Weiseman, then the SBA Inspector General who testified on the appropriate role for SBA and the government in overseeing the activities of COSBI; representatives of the SBIC and MESBIC industry and representatives from Wall Street who advised the Committee on whether COSBI would be able to sell its securities in the marketplace if it were required to purchase the SBIC portfolio without recourse to the government.

The Committee did not report the legislation. As mentioned earlier, the proposal did pass the House as a part of reconciliation but was not agreed to in the final conference report.

A. MINORITY BUSINESS DEVELOPMENT

The Committee's involvement in and commitment to minority business development was manifested in many ways throughout the 99th Congress. Legislation that will directly affect the implementation of programs under the SBA Office of Minority Small Business and Capital Ownership Development (MSB/COD) was enacted; a survey instrument to assess the 8(a) program's effectiveness and the impact of graduation on participating firms was created, and extensive staff monitoring of the day-to-day functioning of the various facets of MSB/COD are examples of Committee activities. The Committee developed a bipartisan relationship throughout the 99th Congress on minority business development issues as it carried out its oversight and legislative responsibilities.

8(a) Pilot Bill

A bill to extend the Section 8(a) Small Business Administration pilot program through FY 1988 was signed into law by the President on Monday, October 27, 1986. The bill, S. 1914 (identical to H.R. 2787), was introduced in the Senate by Committee Chairman Lowell Weicker, Jr. and Ranking Minority Member Dale Bumpers.

Section 8(a) of the Small Business Act authorizes the head of the Small Business Administration (SBA) to enter into contracts with federal agencies and to subcontract the work to socially and economically disadvantaged small businesses. Prior to 1978, the 8(a) program was administered by SBA primarily to provide minority businesses with an opportunity to contract with the government, but the program lacked any specific mission beyond contract assistance. Public Law 95–507, enacted on October 24, 1978, give statutory structure to the 8(a) program, created the Office of the Associate Administrator for Minority Small Business and Capital Ownership Development, and placed greater emphasis upon the business development of minority firms certified for participation in the program. Business development encompasses management training and technical assistance as well as contract assistance.

Public Law 95–507 also established two pilot programs to improve SBA's ability to develop minority firms certified for the 8(a) program. The pilot programs, the Procurement and the Surety Bond Waiver pilot programs both expired on September 30, 1985. On December 16, 1985, the House of Representatives passed H.R. 2787, an Act to extend both pilot programs through FY 1988. The bill was then referred to this Committee.

The Committee held a hearing on March 27, 1986. Chairman Weicker presided. Testimony was received from pilot contractors and Representative Parren J. Mitchell, Chairman of the House Small Business Committee; SBA, and Department of Transportation (DOT) representatives. In addition, the Committee received written testimony from the National Association of Minority Contractors, the Latin American Manufacturers Association, National Federaton of 8(a) Companies and the Black President's Round

Table Association, which represent thousands of minority owned businesses across the nation.

On May 21, 1986, the Committee held a mark-up session and, on a motion by Senator John Kerry, unanimously ordered H.R. 2787 favorably reported. The procurement pilot, the principal program reauthorized by this legislation, gives SBA increased authority to select and reserve a steady stream of quality contracts from an agency designated by the President. These contracts are then matched with the capabilities of 8(a) portfolio firms.

Under the regular 8(a) program, minority small businesses have traditionally received less sophisticated contracts, predominantly in janitorial and service areas. This practice has limited the growth potential for firms that are regular 8(a) program participants. The pilot authority was intended to give SBA the necessary "clout" to address that problem, at least with the designated procuring agency.

The Surety Bond Waiver Pilot is the second program extended by this legislation. Under this authority, SBA can waive surety bonding requirements for section 8(a) start-up firms if certain other requirements are met. This program is intended to give SBA a tool to help minority firms develop a track record and gain government contracting experince. Since the program was originally authorized in 1978, however, SBA has never utilized bond waiver authority. Committee members felt strongly that SBA should activate and administer this program and gather empirical data to determine its effectiveness.

Both pilot programs have been vigorously supported by the minority business community in general and specifically by all of the pilot contractors and associations referred to above. In summary, testimony presented by witnesses at the March 27 Committee hearing was that without the pilot program contractors' opportunities would not have been available. Contractors testified that the pilot program authority helps penetrate institutional resistance of procuring agencies to award sophisticated, long-term contracts to minority businesses. Further, the visibility and importance that Congress and the designated agency give the pilot program makes the program work. Specific examples of testimony follow:

Jerry Jones, President of Sonicraft, Inc. of Chicago, Illinois, stated:

> The Federal Aviation Administration would not have awarded Sonicraft its current contract [to design, manufacture, and test radio control equipment] in the absence of the Pilot Program, even though our company was capable of performing the requirement in comparison with other large companies . . . The federal government tends to believe that large contracts should be awarded to large companies; the pilot program is changing this view . . .

Mr. Robert Ozuna, President, New Bedford Panoramex of Santa Fe Springs, California, further stated:

> It is essential that the pilot program continue because of the unique procurement opportunities it provides to small companies, specifically in performing multi-year, high-tech

> requirements . . . The DOT pilot contract has been crucial in the development of my company.

The National Association of Minority Contractors (NAMC) also submitted written testimony for the record in support of the program. This statement included the following:

> NAMC fully supports the passage of H.R. 2787 . . . These pilot programs go much further than the regular 8(a) program. Generally, under the 8(a) program the federal agencies have final authority on which contracts to select for the program. Under the pilot program, however, the Small Business Administration (SBA) may unilaterally select from an agency, in this case the Department of Transportation (DOT), any contract for use in the 8(a) program. The greatest benefit of the particular 8(a) company involved, however, is that the contract selected must have high-dollar value, or high-dollar value potential or substantial growth potential. Moreover, the selected contracts would be those not otherwise offered by DOT under the 8(a) program.

A letter from the Latin American Manufacturers Association (LAMA) also included a strong statement of support for the program:

> The 8(a) pilot program has given the SBA a significant tool to leverage larger, more technical requirements for minority firms from the Department of the Army and the Department of Transportation, the two agencies wherein the pilot authority has been used on a test basis. There is absolutely no doubt that the types of requirements let by the Army and DOT would not have occurred without the pilot program.

Since the pilot program's inception in 1978 and throughout its tenure, the SBA has testified against the concept of the program mainly because it was felt that the additional authority provided was unnecessary. The Administration testified at the March 27 hearing, "The pilot program gives SBA a 'club' which we don't feel is necessary to obtain more and nontraditional requirements for the 8(a) program. We believe that the objectives of the legislation can be handled as well under the regular 8(a) program." The Administration has since shifted its position and pledged its support of the new extension for the pilot program.

On June 25, 1986, H.R. 2787 passed the Senate with an amendment and in September the amended bill cleared the Congress and was sent to the President. On October 7, 1986, the President vetoed H.R. 2787 primarily because of the amendment added in the Senate. On October 9, 1986, Chairman Weicker and Senator Bumpers introduced a clean version of the pilot legislation, S. 2914, which passed the Senate and later the House. On October 27, 1986, the President signed Public Law 99-567, which extended the pilot program through the end of FY 1988.

Since the pilot program's initial authorization in 1978, it has been extended twice. From 1983 until it expired in 1985, the program operated in the Department of Transportation, where it

seemed to work effectively. This Committee's recommendation is that the program remain in DOT in order to build on the experience and accomplishments gained in order to provide the Congress the necessary data for assessment and future planning for the operation of the 8(a) program.

Minority Enterprise Development Week

The week of October 5–9, 1986 was designated "Minority Business Development (MED) Week" by President Reagan. This was the fourth annual observance of MED Week since the President proclaimed in 1982 that the first full week in October would be so designated. The SBA and the Minority Business Development Agency (MBDA) held events honoring distinguished minority entrepreneurs from around the nation throughout the week.

Chairman Weicker issued a statement of recognition and support of the event:

> . . . minority businesses make a significant contribution to our nation's economy and our local communities. It is with pleasure that I express my own admiration and gratitude to the minority business community for the strides made and the essential role its many entrepreneurs have played in our daily lives. Historically, in this nation, ownership of a business has been a vital part of the American dream. It is the essence of our independent spirit, the attainment of a goal that brings with it self-sufficiency, determination and the personal joy and satisfaction of making it on your own. Unfortunately, for many years minorities did not share in that dream. Our free enterprise system has, in the past, shut most doors to all but a special few of the minority community who tried to share this nation's generous economic pie. But I am proud to say that we are making strides in reversing that harsh trend. Today, the achievements of minority-owned firms are some of the finest success stories this nation has to offer. In all phases of business, increasing numbers of entrepreneurs are getting a bigger slice of the pie through hard work, perseverence, and determination to overcome racial barriers in order to succeed. This is the real American dream that any man or woman, no matter how humble their beginnings can, through their own diligence and effort, become a success in this country. . .

Twenty-eight large corporations received awards for their policies and support of minority enterprise development, including Procter and Gamble, Tenneco, Inc., Pepsi Cola Co., Eastern Airline, United Technologies, RCA Corporation, Southern Bell, Kaiser Electronics, Boeing Aerospace, BDM International and others. In addition, the U.S. Conference of Mayors endorsed MED week through a Resolution.

Winners of National Awards during MED Week Activities included:

(a) National Minority Entrepreneur of the Year: Hung J. Doan, Doan's Nursery, Inc., Orange, Texas.

(b) Minority Entrepreneur: Ms. Willie Carn Nemmons, Infinite Creations, Bomberg, South Carolina.

(c) National Minority Construction Firm: John Chavez Corella, Corella Electric, Inc., Phoenix, Arizona.

(d) National Minority Retail Firm: Atilano Cardero Badillo, A. Cardero Badillo, Inc., Catono, Puerto Rico.

(e) National Minority Service Firm: Thomas A. Farrington, Input-Output Computer Services, Inc., Waltham, Massachusetts.

(f) National Minority Advocate: Marion Harris-Larnie Harton, International and Domestic Development Corp., Fayetteville, North Carolina.

(g) National Minority Manufacturer: Lawrence J. Cormer, Technology Industries Corp., Jamaica, New York.

(h) National Minority Supplier/Distributor: Phillip Martin, CHATA Enterprise, Choctaw, Philadelphia, Mississippi.

(i) Federal Minority Contractor of the Year: Nathaniel Smith, Ver-Val Enterprises, Inc., Fort Walton Beach, Florida.

Additional awards were presented to 23 other recipients by SBA and MBDA agency directors, Federal, state and local agencies and the ten regions of SBA.

Survey of Minority Small Business Section 8(a) Program Graduates

The Senate Committee on Small Business staff conducted a survey of Section 8(a) graduates during the last half of the 99th Congress as part of the Committee's oversight of Public Law 96–481, enacted October 24, 1980, which required the SBA to establish graduation criteria for all firms participating in the 8(a) program. Pursuant to the law, SBA established a Fixed Program Participation Term (FPPT) for each 8(a) certified firm requiring that a definite graduation date be set at the time of program entry as well as for the firms already in the program.

According to guidelines for establishing an FPPT, the period of time a firm could remain in the 8(a) program would be up to five years and no more than seven if granted an extension by SBA. A formal written request for an extension must be made by the firm at least one year in advance of the established graduation date. These guidelines were implemented in April 1982 with the first group of firms leaving the program according to FPPT six months later in October.

Prior to enactment of P.L. 96–481, firms were allowed to remain in the program for extended time periods with no consistently applied graduation criteria. In a ten-year period from 1968 to 1978 only about 200 8(a) firms left the program, or graduated. SBA was sharply criticized by the minority business community and other advocates of the program for awarding contracts to many of the same firms repeatedly and not allowing new companies to enter the program. However, since enactment of the law and enforcement of FPPT guidelines, more than 450 firms graduated from the program in a four-year period from October 1982 through February 1986.

Concerned about the impact of the new law on firms that were graduated, and especially their ability to survive in the private sector, the Committee felt it was most important that contact be

established in order to get feedback from these owners. To accomplish this, the Committee, with input from SBA and support from Congressional Research Service (CRS), created a survey instrument which would:

(a) Establish new contact with graduated firms;
(b) Provide data on the status or healthiness of firms since leaving the program pursuant to P.L. 96–481;
(c) Assess the effectiveness of the business development aspects of the 8(a) program in preparing firms to compete or become self-sufficient in the private marketplace; and
(d) Provide information that may be useful to Congress in maintaining or restructuring certain phases of the program.

The Committee also solicited input in formulating the survey instrument from several minority business associations, including National Association of Minority Contractors (NAMC), Latin American Manufacturing Association (LAMA), and National Federation of 8(a) Companies, and Black Presidents' Roundtable Association.

On August 14, 1986, 497 surveys were mailed to 8(a) graduates, using computer listings provided by SBA. The sample size was later reduced to 461 firms that graduated in a four-year period from 1982 to 1986 because it was discovered that the computer lists used for mailing included a number of errors. One hundred seventy-seven firms responded to the survey resulting in a response rate of 38 percent.

The Senate Computer Center provided support to the Committee in tabulating and analyzing results with the continued input of Congressional Research Service in structuring the total findings. The following is a brief synopsis of the survey's preliminary findings:

Most graduated firms have remained in the same industries with a majority being concentrated in construction or related fields and janitorial services and maintenance.

In measuring the healthiness of firms that responded, most owners said they were doing well enought to get by or doing very well. According to financial and other numerical data provided by these respondents, such as number of employees, sales and net profit, a large percentage of the graduated 8(a) firms ranked in the top quartile of minority small businesses nationally.

Most respondents viewed the program as a contracts program but sharply criticized it as a business development vehicle which would include management and technical assistance as well as contract support.

Many firms felt they were dropped from the program and that SBA or MBDA did not provide a transitional or phase-out period prior to or after graduation. Most firms said they were not contracted by MBDA before or after graduation.

The impact of graduation on firms produced mixed and, in some cases, contradictory results. Some respondents said graduation had a devastating effect and that their firm failed to grow after leaving the program. However, most firms said they would not likely go out of business because of graduation and that they were becoming competitive in the private sector.

A majority of the respondents felt they did not have enough time in the program. Many firms felt the optimum length of time for participation was 10 years, however, most firms felt the program should be based on the firm's development, not number of years.

Only 18 of the 177 firms responded that they were no longer in business. This would result in an "Out of Business" rate of about 10% over 4 years or about 2.5% each year for the owners that responded. However, the overall possible "Out of Business" rate could be much larger. A number of firms could not be located or traced by mail or telephone and are possibly no longer operating.

Slightly more than half of the survey respondents indicated they continued to receive federal government and commercial contracts after graduating and entering the competitive marketplace. Slightly less than half of the respondents said they also won state and local government contracts. However, very few have become subcontractors to major prime contractors.

All but 4 of the 177 firms that responded maintained their minority ownership after graduating from the 8(a) program. Only 1 of the 4 became majority owned while the other 3 shifted to no ethnic majority.

The Committee expects to release the final report of all survey tabulations and findings early in the 100th Congress.

B. VETERANS OUTREACH

On November 13, 1985, at the request of Senator John Kerry and Senator John D. Rockefeller, the Senate Committee on Small Business held an oversight hearing concerning the activities of the Small Business Administration's (SBA) Office of Veterans Affairs (OVA). Chairman Lowell Weicker, Jr., stated the purpose of the hearing:

> To explore whether SBA has fulfilled its statutory mandate of providing "special consideration" to veterans of the Armed Forces in administering its programs. This hearing will focus on how effective SBA's delivery of services to veterans has been, as well as recommendations for improvement.

The hearing did much to reveal many of the problems the OVA has faced adhering to Public Law 93-237, which mandates that veterans receive "special consideration" in all programs provided by the SBA. Witnesses who testified on behalf of veterans' interest groups included: Jerry Boren, School of Social Work, Boston College, Chestnut Hills, Massachusetts; James G. Bourie, national service director, AMVETS, Lanham, Maryland; Paul R. Camacho, assistant director, William Joiner Center, University of Massachusetts; Dennis M. Cullinan, special assistant, National Legislative Service, Veterans of Foreign Wars; Harold S. Gurwitz, veteran, Lynn, Massachusetts; Thomas E. Hartin, Dallas Vietnam Veterans Leadership Program, Inc.; Gordon H. Mansfield, national advocacy director, Paralyzed Veterans of America; and John M. Messmore, chairman, National Economic Affairs Committee, Vietnam Veterans of America (VVA), accompanied by Richard Weidman, director of Government Relations for the VVA.

These individuals furnished the Committee with an excellent picture of the obstacles veterans must overcome in starting a small business. In addition, the witnesses stressed the valuable input the veteran can provide to the entrepreneurial spirit of our nation. "Military service instills in one a sense of mission, discipline, teamwork, responsibility and other positive attributes necessary for a successful business," stated James Bourie, National Service Director, AMVETS. As a result of the testimony provided, the Senators concluded that the average veteran is a prime candidate to receive assistance from SBA in starting his or her own business. In profiling the average Vietnam-era veteran, it was determined:

The average Vietnam-era veteran is 39 years old; 60 percent of all businesses are started between the ages 35 and 45.

World War II veterans led the economy to great heights of entrepreneurial growth following the war; Vietnam veteran can lead the economy in the 1980's and 1990's.

Vietnam veterans possess the necessary education, small business work experience, and leadership skills to be successful in their business ventures. According to Senator John Kerry, "The business failure rate of Vietnam veterans is just 1.7 percent."

As Senator Alfonse D'Amato as aptly stated, "Support for the SBA veterans program is support for small business."

Testifying at the hearing on behalf of SBA was Marshall J. Parker, Associate Deputy Administrator for Special Programs, accompanied by Leon J. Bechet, Acting Administrator of OVA. Mr. Parker and Mr. Bechet outlined the specific problems the OVA has encountered, and measures taken by the SBA and Congress to alleviate them. Specifically, the SBA cited outreach as the major problem inhibiting the SBA from reaching its full potential in its OVA programs. A major conclusion drawn by the Senators involved in the hearing was that SBA had sufficient resources in terms of veterans assistance financing but lacked the actual outreach capability to provide the direct assistance to veterans. Senator John Kerry said:

> SBA should renew its outreach efforts to the veterans' community, including widespread dissemination of basic information, to its own employees as well as to the public.

The 99th Congress, aided by the testimony provided by the Committee's November 1985 hearing, enacted Section Ten of the Omnibus Reconciliation Act of 1985. This provision called for the formation of Veterans Business Resource Councils (VBRCs) to be located in certain regional areas, so that SBA could be more responsive, and provide better outreach for training and services. During the debate of Senator Rockefeller's amendment to set up VBRCs, Senator Dale Bumpers, Ranking Minority Member of the Senate Committee on Small Business, suggested ". . . that the SBA develop recommendations to assist in the establishment of the VBRCs." With the formation of the VBRCs, SBA took Senator Bumpers' suggestion and set up local Vietnam Veterans Leadership Programs (VVLP). These VVLPs were formed through grants and private sector donations to assist the VBRCs on a more local level, providing more accessible avenues for the veterans to take to receive assistance from the SBA.

The VVLPs have become an important asset to veterans, Vietnam-era veterans in particular, providing technical and management assistance for starting a business, and/or applying for an SBA loan. The VBRCs along with the VVLPs have proven to be very successful in coordinating programs offered by the SBA in overcoming the Vietnam veterans' distrust of government, actively seeking their involvement, and getting the SBA veterans programs moving.

Since the time of the hearing, some administrative problems have been alleviated: a permanent director has been appointed to head the Office of Veterans Affairs; the ten regional SBA offices have been authorized to assign full-time Veterans Affairs Officers to assist veterans on a regional basis, although none of those positions had been filled by the end of the 99th Congress; and the new *SBA Veteran Assistance Handbook* has been printed and distributed to the local and regional offices.

One of the most significant changes occurring within the OVA is the increased usage by the veteran community of the programs provided by the SBA. As shown in Table I, fiscal year 1986 has demonstrated a significant increase in the Vietnam-era and Disabled Veteran Loan Program. This year an increase of $11.2 million more was allocated to veterans than in monies loaned in FY 1985. It is important to note that 68 percent of the loans distributed were distributed in the last half of FY 1986, after the time of the November hearing, when the actions taken by Congress and SBA were put into effect. In FY 1986, for the first time since the inception of the program in FY 1983, the OVA was able to distribute the total funds appropriated for the Vietnam-era and Disabled Veteran Loan Program. Due to the Gramm-Rudman-Hollings budget sequestration, the original $20 million appropriated for this program was reduced by $.8 million to $19.2 million.

TABLE I.—SBA VETERAN LOAN ASSISTANCE

[In millions of dollars]

	Fiscal year—		
	1984	1985	1986
Total all direct loans under the Vietnam Era and Disabled Veteran Loan Program ($20,000,000 appropriation per year)	19.8	8.6	[1] 19.2
Guaranteed Loan Program, total per year to veterans	673.7	608.7	0

[1] Total funds allocated due to Gramm-Rudman-Hollings sequestration.

In summary, several improvements have recently been made with regard to SBA's adherence to the "special consideration" requirement of Public Law 93-237. However, the Senate Committee on Small Business and SBA intend to ensure that these improvements continue and that veterans receive the special assistance they deserve. The Senators on the Committee, their staffs, and all SBA personnel are continually looking for areas of improvement to make sure that the commitment Congress and the nation have made to veterans seeking business opportunities is honored. According to Senator John Kerry:

The Committee is determined to ensure that the outcome of the hearings which the Committee held in November will provide concrete and measurable improvements in the services and programs offered to veterans by the Office of Veterans Affairs. The purpose is not to search for problems or shortcomings but to try to find ways that this Committee and all of us as members of it can assist and help the SBA to be able to perform that function with the notion that we can always do better. We should always try to do better.

C. WOMEN IN BUSINESS

One of the most exciting developments in the area of entrepreneurship is the rapid growth and success of women-owned businesses. According to the latest U.S. Economic Census Bureau Report, the number of women-owned businesses in 1982 totaled 2.9 million; of this number, 2.7 million were individual proprietorships. Women now own 25 percent of the nation's small businesses, up from 5 percent in 1976, and by the year 2000 the Small Business Administration (SBA) predicts that women will control half of all small businesses. The days when a woman-owned business was considered just a novelty are long gone. Today, women business owners are in the forefront of the entrepreneurial revolution and are central to the continued economic growth and prosperity of the country.

Several factors account for this tremendous growth of women entrepreneurs. The increased participation of women in the labor force is the main reason. Today, there are approximately 38 million working women. They are the fastest growing segment in the labor market. Between 1950 and 1985 the number of women in the labor force increased by 178 percent, while the number for men rose by only 47 percent.

A growing desire on the part of many women for increased flexibility in employment is another factor that has boosted women entrepreneurship. Women entrepreneurs, like their male counterparts, want to be their own bosses. They like the sense of independence and satisfaction that comes from running one's own show. The ability to perform work where it may be convenient and at convenient hours is very attractive to many women who must structure their own work around child care. Of the 1.33 million home-based businesses operating nationwide in 1980, 35 percent or 456,000 were headed by women.

Education also plays an important role in the development of women entrepreneurs. According to a study commissioned by the SBA, the average businesswoman has completed almost 15 years of formal education, and almost 72 percent have attended college at least one year. Half of the women have taken business courses, and 36.4 percent have taken vocational courses. Education has become a crucial tool in helping to give women the training and the skills necessary for running a successful small business.

Another reason for the rapid rise of women business owners is the expanding role of small business in the economy, especially in the service sector. Recognizing this trend, women are starting their own businesses. In fact, 74 percent of women-owned businesses are

involved in the services and retail trade which makes up 64 percent of gross receipts. Although the retail service area has been the traditional domain of women business owners, more and more women are making inroads in such fields as manufacturing, construction and agriculture. In fact, receipts for women-owned businesses posted their largest increases in construction. Overall, businesses owned by women had gross receipts of $98.3 billion, or 1/10 of all business receipts. One half of the receipts were from individual proprietorships, while 30 percent came from corporations and 20 percent from partnerships.

This tremendous growth of women-owned businesses has occurred throughout the United States. The five states with the largest number of women-owned businesses—California, Texas, New York, Florida, and Pennsylvania—accounted for 37 percent of all women-owned businesses in 1983. The greatest density of women-owned businesses is in the Pacific region (18.7 percent), and the least density is in the East South Central region (4.9 percent).

The future for women entrepreneurs looks bright. During the past decade, women have been making tremendous inroads and overcoming numerous obstacles in an attempt to carve their niche in the entrepreneurial economy. Several factors such as the expanding role of small business in the nation's economy and the influx of women in the workforce have played a pivotal role in the growth of women-owned businesses. The Small Business Administration through its Office of Women's Business Ownership (OWBO) has monitored and sought to encourage the development of women business enterprises. During 1986 the OWBO developed programs related to women business ownership.

On April 17, 1986, the OWBO sponsored the MegaMarket I Day Procurement Conference in Washington, D.C. The conference not only provided women business owners with information about how to market their goods and services, but helped match, by computer, women business owners with top government and corporate buyers from Pennsylvania, Delaware, Virginia, West Virginia, Maryland, and Washington, D.C. In addition to this procurement conference, the office was involved in organizing five, one-day conferences on home based industries. These conferences examined such issues as zoning, licensing, marketing, accounting, and legal aspects of running a business from your home, as well as discussions on how to develop a strategy for successful business development and growth. The conferences were held at the following locations:

September 13, 1986, Boise, Idaho.
September 18, 1986, Birmingham, Alabama.
September 24, 1986, Charleston, West Virginia.
September 27, 1986, Wichita, Kansas.
October 22, 1986, Houston, Texas.

D. REGULATION AND PAPERWORK

Introduction

During the 99th Congress, the Committee has continued to be involved in monitoring the rulemaking process of the various executive agencies. Three areas of particular focus were: 1) agency compliance with the Regulatory Flexibility Act; 2) implementation of

the Equal Access to Justice Act; and 3) the Environmental Protection Agency's (EPA) promulgation of compliance rules under the Resource Conservation and Restoration Act (RCRA) and the Comprehensive Environmental Response and Liability Act (CERCLA), (otherwise known as Superfund).

Regulatory Flexibility Act

The Regulatory Flexibility Act of 1980 (RFA), 5 U.S.C. Sec. 601, *et seq.*, requires Federal agencies to consider the impact of their proposed regulations on small businesses. The law requires agency rulemakers to adjust regulatory and informational requirements to the scale of the business, organization or governmental entity subject to the rule. The SBA's Chief Counsel for Advocacy is charged by the statute with monitoring agency implementation of the RFA. The Act requires agencies that promulgate rules pursuant to section 533(b) of the Administrative Procedures Act to:

Publish a semi-annual regulatory flexibility agenda that contains a brief description of every rule the agency expects to propose that may have a significant economic impact on a substantial number of small entities.

Publish an Initial Regulatory Flexibility Analysis (IRFA) for each proposed rule that explains the reason for the rule, gives an estimate of the number of small entities it will affect, provides a description of the reporting and compliance requirements anticipated, and offers a description of significant alternatives to the proposed rule.

Publish a Final Regulatory Flexibility Analysis for each final rule that explains the need for the rule, gives a summary of issues raised during public comment and provides the reasons for rejection of significant alternatives.

For each rule that does not contain an IRFA, publish a certification stating that the proposed rule will not have a signficant economic impact on a substantial number of small entities.

Assure that small entities are given an opportunity to participate in the rulemaking process.

Publish a plan for periodic review of rules issued including all those in effect on January 1, 1981, by the agency in the *Federal Register*.

The law also specifies that SBA's Chief Counsel for Advocacy has the overall responsibility for monitoring agency compliance with the Act and authorizes the Counsel to appear as an amicus curiae in legal proceedings dealing with the Act.

In its annual report on implementation of the RFA, the SBA reported many significant achievements in the implementation of the Act. Focus upon the EPA, which is charged with the issuance of very far-reaching regulations of enormous impact on the small business community, demonstrated the use of innovative regulatory rule-making. The use of negotiated rulemaking has enabled both the agency and the affected community to communicate and identify major issues and facilitate a well considered rule without the extended delays involved in redrafting and protracted comment periods. Improved implementation of the RFA has been seen within

the procurement and rulemaking activities of the Department of Defense (DOD).

Nonetheless, considerable concerns still exist in agency implementation of RFA. The use of immediately effective "interim rules" is often applied with little or no impact analysis, certification, or insufficient analysis of the proposed rule's effect on small businesses. Of large significance is the failure of the Internal Revenue Service (IRS) in applying the RFA to interpretive rulings or even standard formal rulemaking procedures. The Committee will address this issue in the near future as the IRS undertakes the task of implementing the new Tax Reform Act.

Equal Access to Justice Act

The Equal Access to Justice Act (EAJA) provides that in judicial and administrative proceedings in which the United States is the losing party federal courts and federal agencies shall, in certain circumstances, order the United States to pay the attorney's fees of the prevailing party. The EAJA as originally enacted in 1980 as Title II of P.L. 96-481, and took effect October 1, 1981, and was amended in 1982 by section 292 of P.L. 97-248. Part of EAJA was to sunset in 1984 but was permanently reauthorized and amended by P.L. 99-80, which took effect on August 5, 1985.

The EAJA allows awards of attorneys' fees against the United States in two broad situations. 28 U.S.C. section 2412(b) makes the United States liable for the prevailing party's attorney's fees, to the same extent any other party would be liable under the common law or any statute which provides for awarding fees or expenses. 5 U.S.C. section 504 and 28 U.S.C. section 2412(d) provided that in specified agency adjudications and in all civil actions (except tort and tax cases) brought by or against the United States, the U.S. shall be liable for the attorneys' fees of prevailing parties, unless it proves that its position was substantially justified or that special circumstances make an award unjust. This part of EAJA limits fee awards of $75 per hour unless the court or agency determines that a special factor justifies a higher fee.

Considerable debate has existed within the small business community regarding the application of EAJA. The Committee has recently observed the White House Conference on Small Business' call for subjecting the IRS to all the standards of the EAJA. The resolution also recommended amending the EAJA to define recoverable costs to include accounting, legal and other professional fees plus administrative costs. A likely cause for the resolution is the EAJA exclusion of awarding attorneys' fees against the United States in Tax Court. The Tax Reform Act of 1986, while not placing tax cases back within EAJA, amended section 7430 of the Internal Revenue Code of 1986 to be more similar to EAJA. Section 7430 of the Internal Revenue Code provides for awards against the United States for litigation costs, including reasonable attorneys' fees in any civil proceeding brought in federal court in regards to the Internal Revenue Code. Section 7430 now contains the same limitations as EAJA on the net worth of eligible plaintiffs and on hourly rates.

Community Right-to-Know Hearing

The Committee undertook consideration of Community Right-to-Know legislation and its regulatory and paperwork impact on small businesses. The accidental release of methyl isocyante (MIC) in Bhopal, India, raised a variety of issues concerning the manufacturing, handling and emission of toxic chemicals in the United States. These concerns were grouped into the areas of:

Dissemination to the public information known about chemicals within businesses and their exposure to workers and the community;

Creation of a national inventory for hazardous substances to aid the regulatory efforts on the local and national level;

Assessment of the control, use and transportation of hazardous substances in order to avoid the tragic consequences of a major chemical release and exposure to a large population.

The Committee's hearing on June 18, 1985, included testimony from the EPA, SBA Office of Advocacy, the International Association of Fire Chiefs, environmental and industrial groups along with small business manufacturers and local municipalities. Substantive testimony was collected regarding the potential requirements on small business in complying to community right-to-know proposed legislation and the impact on communities and authorities of collecting and dealing with an expected flood of compliance documents. This hearing record and testimony was a significant examination of the issue and influenced the final provisions found in the recently passed Superfund reauthorization signed by the President on October 17, 1986. The reauthorization specifies:

The establishment of a state emergency response commission with the subsequent creation of local emergency planning committees and districts which will be notified by businesses handling one or more hazardous chemicals listed by the EPA;

Notification to the established committees of chemical releases;

Submission of Material Data Safety Sheets to local and state authorities detailing the specific chemicals and hazards;

Submission inventory forms detailing the identity, quantity and location of chemicals at a business site.

Threshold levels and reporting requirements are constructed to waive de minimus users and many small businesses from required reporting of small quantities of chemicals.

Oversight and Committee involvement has occurred in the development of various environmental regulations of the EPA. Briefly, the Committee has directed staff to monitor and respond to regulation development of the handling and disposal of used oil, management and monitoring of underground storage tanks, and handling and reuse of cleaning rags and solvents. Staff has participated with interested groups and the SBA Office of Advocacy in cooperation with involved EPA offices and the EPA Small Business Ombudsmen Office. The proposed and final drafting of these regulations has very broad and significant impacts upon the small business community. The Committee has been impressed with the current level of responsiveness that the EPA has shown to interested parties.

Chapter III. Impact of Tax Reform on Small Business

During the 99th Congress, tax reform was at the forefront of the legislative agenda. President Reagan raised the idea of sweeping tax reform during his 1984 State of the Union Address, and after his reelection he announced it would be his top domestic priority. Consequently, it was clear to Members of the 99th Congress that significant changes in the tax code were in the offing, and that such changes would revolve around the concepts of equity, simplicity and revenue neutrality.

Despite a tortuous history during which on repeated occasions tax reform looked dead for the Congress, the most sweeping, if not revolutionary, tax bill passed the House on December 17, 1985, on a voice vote, and the Senate on June 24, 1986, by a vote of 97-3. After weeks of private discussions between the Senate Finance Committee Chairman and the Chairman of the Ways and Means Committee, the Conference Committee reported out H.R. 3838 in its final form. Final passage occurred by substantial majorities in both Houses during the week of September 20. However, six of the 20 members of the Small Business Committee, including the Chairman, voted against the bill; the others were Senators Boren, Levin, Nickles, Nunn, Pressler and Sasser.

The Small Business Committee, which has long sought to assure that the nation's tax laws provide incentives to assist small business, was vigilant throughout the 99th Congress in gauging the impact on the nation's 15 million small businesses of the proposed changes in the tax code. Based in large part upon recommendations offered at Committee hearings across the country on proposed changes, a number of legislative proposals, sought the inclusion of provisions to level the playing field and allow small businesses to compete with large firms.

Senator Lowell Weicker, Jr., the Committee's Chairman, and Senator Dale Bumpers, Ranking Minority Member, repeatedly expressed their concern that the core of carefully crafted small business tax incentives in the current code—including those which help small firms to attract and retain capital, remote capital investment, increase productivity and enhance private sector job creation—might unravel with the enactment of sweeping tax reform. Further, in recognition of the vital impact that the nation's small businesses have on the health of the economy, the Chairman and Ranking Minority Member emphasized the importance of taking the needs of the small business sector into consideration throughout all phases of tax reform discussions and debate by federal tax policy-makers.

In a memorandum circulated to all Committee Members on November 20, 1984, Senators Weicker and Bumpers stated:

> One of the major issues that will dominate the new Congress is "tax simplification" . . . We believe it is imperative that the Senate Small Business Committee be prominently involved in any tax reform debate, as an advocate for our small business constituency. In our view, for any tax reform legislation to be successful, it must have the support of small business.

This memorandum further described some of the Senators' prime concerns and the need for hearings on this issue. The Senators noted:

> A key ingredient to the small business support is their involvement in the decision-making process. For example, will the various tax reform proposals have any effect on small business' ability to raise or retain capital? What impact would an elimination of the investment tax credit (ITC), have on small businesses? What tax "reform" options could be acceptable to the small business community? An extensive hearing record will need to be developed within the Committee is we are to have the substantive foundation from which to participate in this debate.

Various Committee members introduced during this Congress legislation to better serve small business, some of which later reappeared as different provisions of H.R. 3838, at least as passed by the Senate. Senator Weicker introduced a long-standing favorite small business capital formation proposal: the Small Business Participating Debenture (SBPD) (S. 1498), which was part of the Finance Committee's original draft version of H.R. 3838. Senators Bumpers, Sasser and Baucus introduced different bills (S. 396, S. 1130, and S. 1513, respectively) that would have required the Internal Revenue Service (IRS) to comply with the Regulatory Flexibility Act, each along with various other provisions; this provision was part of the Senate-passed version of H.R. 3838, but it did not survive the Senate-House conference on the final legislation. Senators Bumpers' and Baucus' bills also provided that the intent of the Equal Access to Justice Act be extended to apply to cases brought by or against the government in the United States Tax Court (a form of which is a provision of the final version of H.R. 3838). Further, Senator Baucus' bill provided that undeposited payroll taxes due the IRS from an employer can be aggregated until monthly deposits exceed a threshold of $5000 rather than the current law $3000; this also is a provision of the final H.R. 3838.

With these proposals in mind, the Committee held a series of 13 field hearings across the country in 1985 to examine the impact of tax reform proposals on small business. With passage of H.R. 3838 in the House of Representatives on December 17, 1985, the Committee moved the location of its hearings to Washington. While the Senate Finance Committee was debating the principles of tax reform, the Senate Small Business Committee held a full-day hearing on the impact of tax reform on small business on February 6, 1986. An overwhelming majority of witnesses had grave misgivings about the House-passed version of H.R. 3838, which bore a considerable resemblance to the final package which the President signed on October 22, 1986. After passage of H.R. 3838 in the Finance Committee, the Small Business Committee held an additional day-long hearing on the proposal to eliminate the capital gains differential. An overview of the current situation and a summary of those hearings follows.

Importance of Small Business to the Economy

The small business record of accomplishments has been clearly documented. In 1984, the small business sector once again led the country in job creation, and provided the key to overall economic growth. The recent economic recovery was spurred, in large measure, by the major contributions of America's smallest firms—those employing fewer than 20 persons—which generated all of the one million net new jobs created during the last recession. Industries dominated by small business consistently added jobs at a rate almost twice that of industries dominated by large firms. Between 1980 and 1982, for example, the small business sector created 2.6 million jobs, while large companies lost 1.6 million jobs, and Fortune 500 firms saw erosion of their job supply by a half million positions.

And yet, despite the important contributions of small businesses to the national economy, they have operated for decades under a discriminatory tax policy which fails to address the special disadvantages that small firms face in attracting and retaining capital. Current tax code provisions with their onerous complexities, [including the deductibility of depreciation, which favors larger capital intensive enterprises; advantageous LIFO accounting rules which require costly tax accounting counsel; investment tax credit incentives which apply mainly to new capital; and corporate tax rates which are not progressive enough to permit adequate capital retention] do not adequately address the special needs of small businesses nor provide the necessary tax incentives while ignoring the costly paperwork burdens imposed on small businesses which are often forced to consult with expert tax lawyers or accountants.

Legislative History of Small Business Tax Incentives

The Committee began its efforts to aid small business through specific tax code revisions in February 1981, at the start of the 97th Congress. Senators Weicker and Nunn, Chairman and then-Ranking Member, respectively, introduced a comprehensive tax package, known as the Omnibus Small Business Capital Formation Tax Act of 1981 (S. 360), aimed at making it easier for small firms to retain and attract capital through changes in the tax law. This measure, which was co-sponsored by several Committee Members and a number of other Senators, specifically addressed the difficulties faced by small businesses in attracting long-term capital for new investment in plant and equipment, as well as retaining capital generated internally.

S. 360 took a two-pronged approach to resolving these problems by proposing: 1) significant new tax credits, rollovers, and other incentives to encourage investors to make long-term equity capital available to small businesses; and 2) important new tax provisions to permit greater earnings retention, including reduced corporate tax rates, accelerated and simplified depreciation deductions, reductions in inventory accounting burdens, and reforms in estate and gift tax laws which would permit small firms to retain a greater amount of their earnings.

This 1981 omnibus tax act became the starting point for Senate consideration of small business tax legislation during the first ses-

sion of the 97th Congress, and other small business tax measures were subsequently introduced in the Senate and the House. The Economic Recovery Tax Act (ERTA), contained a number of provisions adapted directly from S. 360, including accelerated depreciation, and estate and gift tax reforms. Senators Weicker and Nunn subsequently offered an amendment to this bill to reduce the corporate tax rates paid by small firms, which passed by a vote of 92–0.

While ERTA and tax measures since enacted have placed provisions to encourage greater capital investment in small business on the books, Congress has failed to fully address the needs of small firms in areas such as the critical shortage of long-term financing. In light of the persistence of unacceptably high real interest rates, and the special financing needs of small businesses, Senators Weicker and Bumpers and other Committee Members believe that measures designed to increase the flow of capital to these firms are necessary.

Committee's Focus on Tax Reform

The Senate Small Business Committee responded to the national focus on tax reform by conducting a series of 13 field hearings in seven states beginning in January 1985 to examine the impact of tax reform on small business and two additional hearings in Washington on February 6, 1986, and June 4, 1986, to address the effect of the proposed elimination of the capital gains differential. Witnesses represented the diverse industries comprising the small business sector, including retailers, manufacturers, realtors, computer software developers, forest products producers, farmers, ranchers, local officials, accountants, lawyers, bankers, restaurateurs, travel and tourism representatives, as well as associations representing these diverse small business groups.

An outline of the hearings conducted by the Committee in 1985, with the represpective locations and dates, as well as the presiding Senator in parenthesis, follows:

State	Location	Date
Tennessee (Senator James Sasser)	Nashville	Jan. 9.
	Memphis	Do
South Dakota (Senator Larry Pressler)	Sioux Falls	Feb. 13.
	Huron	Do
	Rapid City	Feb. 14.
Illinois (Senator Alan Dixon)	Chicago	Mar. 4.
Montana (Senator Max Baucus)	Missoula	May. 28
	Billings	May 29.
Massachusetts (Senator John Kerry)	Boston	July 3.
Washington (Senator Slade Gorton)	Vancouver	Aug. 16.
	Seattle	Aug. 19.
Arkansas (Senator Dale Bumpers)	Fort Smith	Aug. 27.
	West Memphis	Aug. 28.

These hearings provided a broad range of small business owners and operators with an official forum in which to state opinions on how they would fare under the proposed tax reform plans. The differing, and sometimes conflicting, opinions expressed by the witnesses reflect the diversity of the small business sector, and pose

the usual problems attached to summarizing the views of a constituency composed of businesses varying dramatically in size and location, and which span virtually every industry in America.

Witnesses unanimously embraced the concept of simplicity and stability, with many blaming the current complexity of the current code on frequent Congressional tinkering with our tax laws. Many of those testifying favored maintaining current tax incentives, including a graduated tax rate structure for corporations, an accelerated depreciation system, the investment tax credit, and a continuation of the capital gains preference.

Tax Policy Concerns

Simplicity and stability

Many small business witnesses expressed support for a major overhaul of the tax code, provided that this effort would produce a truly simplified code that would be resistant to frequent changes in the future. Many of those who testified, however, were skeptical that any of the current proposals would achieve the goal of true simplification. With this in mind, the witnesses' overriding sentiment was that the code is better off without changes and should be left alone.

Gains Norton of Frost & Company, a Little Rock, Arkansas, firm of certified public accountants, expressed dissatisfaction with the Administration's tax reform package:

> The President's tax proposals to Congress for fairness and simplicity are the keynotes used to attract the attention and support of the public, but the actual proposals are in no way simple nor are they fair.
>
> I've made my living in the income tax section of my profession as a CPA for the last 18 years, and I've lost count of the number of tax reform measures that we've had. Every Congress has wanted to reform the Internal Revenue Code and all it manages to do in the process is make it more complex.
>
> No Congress wishes really to spend sufficient time studying the problem that is existing in the tax law to do it justice.

This sentiment was buttressed by Robert A. Chance from Longview, Washington:

> Yes, I'd rather keep it the way it is because I really think—you know, they advertise that his proposals make the tax law more simple, and I don't think it does. You take a look at all these proposals, at least the ones I've outlined in my testimony, and almost all of them make it far more complicated—maybe not for the individual; it's centered on making it more simple for the individuals, maybe a tax return filing system that doesn't require people to fill out forms and mail them in. Things like that would be far more simple for the individual, but you take a look at almost all these proposal for corporations—far more complex, highly complex computations.

The code has undergone a series of frequent and wide ranging changes in recent years, requiring substantial adjustment in the financial management and operation of most businesses. The following list of significant tax reform measures enacted during the past ten years demonstrates the frequency of amendments over the period:

Revenue Adjustment Act of 1976.
Tax Reform Act of 1976.
Tax Reduction and Simplification Act of 1977.
Revenue Act of 1978.
Economic Recovery Tax Act of 1981.
Tax Equity and Fiscal Responsibility Act of 1982.
Tax Reform Act of 1984.

Typically, small businesses must rely on outside counsel to keep abreast of tax changes and to develop prudent financial strategies within the framework of changes in the code. Valuable time and money must be expended in response to the continually changing tax environment at a time when most businesses need to direct their resources internally to ensure their operating success.

Stability was judged an imperative to allow firms to make long-term plans without the threat of immediate changes or continual adjustments. Such stability would allow long-term planning without jeopardizing market opportunities for firms that are not large enough to be able to absorb adjustments, reversals and corrections, due to yet another tax law change.

Timothy J. Sather, an accountant from Billings, Montana, expressed the sentiment that there is a lack of public confidence in the tax system as a result of the constant changes:

> We cannot stand any more reduction, reform, equity or simplification. Without regard to the specifics of the law, which have consistently made the code more complex, the lack of confidence in the system has been heightened greatly by the constant tinkering with the law, e.g. long-term capital gains. In the past eight years, the waiting period has been . . . six months, nine months, then to one year, and now reduced back to six months.

Small business is in general agreement that significant tax legislation every 12 to 18 months requires a substantial adaptation to a whole new set of rules and regulations. Small business witnesses also expressed great concern that, given the many alternatives being presented for reform, the end result may in fact be more disadvantageous than the system currently in place.

A quote from Alexander Hamilton's Federalist Papers offered by Wayne Oldham, a restaurateur from Nashville, Tennessee, illustrates the general frustration of today's small business owners in the tax code:

> It will be of little avail to the people that the laws are made by men of their own choice if the laws be so voluminous that they cannot be read, or so incoherent that they cannot be understood; if they be repealed or revised before they are promulgated, or undergo such incessant changes

> that no man who knows what the law is today can guess what it will be tomorrow.
>
> And I think that's the situation we're finding ourselves in today with all the tax laws, especially as they affect small business.

A feeling of frustration with the complexity of the code was vividly conveyed by Donald McKnight, a farmer from Parkin, Arkansas, who also noted the irony of a person with no taxable income being asked to comment on the need for simplicity in the tax code:

> It is very admirable for anyone to even propose a simplified income tax system; for after all, it is rather absurd for a small business with only three employees to need the services of a tax accountant to keep abreast of the tax regulations to operate within them.

Bill Yager, a farmer from Billings, Montana concurred:

> My wife and I spent 40 to 50 hours last year trying to fill out 12 pages of Federal tax forms. And we both have college degrees, but we had to get help to complete those forms. Remember, we are talking about a very small, simple business that has no tax liability.

The same basic sentiment was offered by Jim Koessler, who had been a principal in several small business entities and currently is president of Rocky Mountain Capital Limited, a closely held venture capital company, as well as two other venture capital vehicles, one of which is the only SBA-licensed SBIC (Small Business Investment Company) in the state of Montana:

> In my experience, new or small business entities are generally founded by people who have expertise in a particular product or service, but more often than not have limited or non-existent backgrounds in finance or accounting.
>
> They immediately find that they are devoting a meaningful proportion of their time to complying with tax reporting requirements to the detriment of the underlying business . . .
>
> In summary then, our present tax system motivates American business to dedicate substantial amounts of time and money to non-productive activities.

The Committee heard the call for stability in the code from others in the small business community, as well as from witnesses before the panel.

The Committee's National Advisory Council, established in 1981 to obtain grassroots insight into the problems and concerns of the nation's small businesses, is composed of 25 small business persons from around the country who come to Washington each year, at their own expense, to meet with Committee members and other officials to discuss the state of small business from their individual perspectives. As the only such officially recognized advisory body to the Senate, the Council's perspective, which reflects active working members of the small business community, is highly valued. At

their fifth annual meeting in October 1985, the National Advisory Council endorsed the following resolution concerning tax reform:

> Therefore, be it Resolved that, the National Advisory Council to the United States Senate Committee on Small Business does not believe that fundamental change in the tax code is warranted, with the exception of a strong corporate minimum tax. Should Congress decide to enact comprehensive tax reform, any such revision of the tax code must recognize the needs of small business.

This resolution states the Council's preference for stability in the tax code based on its belief that true simplification or reform would not be enacted.

The preface to the Council's resolution cited the strong small business support for retention of certain provisions of the tax code, including preferential treatment of capital gains, graduated corporate tax rates, the investment tax credit, tax-exempt financing for small business, and some form of accelerated depreciation, along with two other provisions. A discussion of each of these major small business concerns follows.

Key Small Business Tax Concerns

Capital Gains

Ordinarily, the gain from the sale or exchange of property is included in its entirety in the income of the recipient and therefore taxed at ordinary income tax rates. Only when a transaction is a long-term capital gain, which requires the taxpayer to hold the property for more than six months, was it subject to a lower tax.

The law until repealed in 1986, provided an exclusion of 60 percent of any long-term capital gain, thereby taxing this income at a maximum effective tax rate of 20 percent for taxpayers in the highest individual bracket, which is currently 50 percent.

Before 1987, a corporation could not take advantage of this 60 percent capital gain exclusion. Instead, a corporate taxpayer had two alternatives for determining tax due on its long-term capital gains. First, the corporation simply included all capital gains in its taxable income and computed the tax due at ordinary corporate rates; or second, in the alternative, the corporation computed the tax due on its actual ordinary income (excluding capital gains) while calculating the tax due on its capital gains at a 28 percent rate, adding these two calculations together. The corporation then used the method that produced the lesser total tax liability. For any corporation that earned more than $60,000 of ordinary income, the alternative 28 percent rate for capital gains yielded the more advantageous result since some ordinary income would be taxed at a greater than 28 percent marginal rate. Otherwise, simply taxing all corporate income at ordinary rates was the more advantageous method.

The capital gains exclusion for individuals was originally devised in recognition of the fact that gains from property do not necessarily accrue in the year of sales, so they should not be taxed as if they do. The quantity of investment and flow of dollars, particularly into small businesses, will be directly governed by the percentage

of gain excluded from tax and the required holding period. Since the exclusion was created, the amount of the exclusion and the required holding period have varied. From 1942, the exclusion was a flat 50 percent for property held six months or longer. In the 1970's, the holding period was extended to twelve months and the exclusion increased to 60 percent, until the Tax Reform Act of 1984 again reduced the required holding period to six months.

In its original proposal of November 1984, the Treasury Department recommended a complete elimination of capital gains treatment on profits from long-term investments. Under that proposal, all earnings from investments which previously received favorable capital gains treatment would have been subject to taxation as ordinary income.

Under the final proposal of H.R. 3838 which was signed into law by the President, capital gains will be taxed like ordinary income, but in no event at a rate higher than 28 percent, even if the top rate for effective ordinary income is raised above 28 percent for individual taxpayers. Corporate taxpayers will have to include all capital gains in determining their ordinary income. There no longer is any exclusion of capital gains.

No single proposed change caused as much consternation in the small business community as the proposed elimination of the capital gains differential, which had been a mainstay of the code since 1921. In order to more fully understand the impact on small business of the proposed changes, the Committee held a exhaustive hearing in Washington, D.C., on June 4, 1986, the day that debate of H.R. 3838 began in the Senate.

Proponents of maintaining capital gains argue that there is a qualitative difference between ordinary income and capital gains due to the increased risk associated with long-term capital investment. Maintenance of the exclusion is required, therefore, not only to reward those who take these risks, but also to sustain the pool of venture capital upon which many small businesses rely. Additional arguments are advanced for the retention of favorable treatment of income from long-term investment. One such point of view recommends excluding capital gains from income on the grounds that the profits could not reasonably be considered available for consumption. Another argument for special treatment of capital gains is that genuine income must be recurrent, and capital gains are not. Defenders of preferential treatment of capital gains also point out that capital gains represent "bunched" income. Even if capital gains are realized in a single year, they are accumulated over several years. Therefore, they should be accorded special treatment. Another argument is that any increase in the current value of capital assets due to inflation should not be subject to tax. This theory emphasizes that capital gains must be relieved from the effects of inflation.

Concern about the economic impact of taxing capital gains, in particular the so-called "lock-in" effect, constitutes the primary justification for the capital gains preference. One study found that, of those who reported a sale of capital assets, nearly 75 percent said they had reinvested the profits. R. Barlow, H. Brazer, and J. Morgan, "Economic Behavior of the Affluent" (1966). Thus, the argument continues, capital gains merit special treatment in order to spur capital investment and promote economic growth. Conclusions

of a recent Treasury Department study reflect several of these theories and criticisms. The study, which was released September 13, 1985, concluded that cutting the capital gains rate in 1978 and 1981 bolstered government revenue at the same time as it boosted long-term economic growth.

Hearings through May 1985 in Tennessee, South Dakota, Illinois, and Montana reflect comments presented to the Committee based on the proposed elimination of preferential treatment of capital gains treatment for any long-term investment. These hearings were held prior to the publication of Treasury II, which reinstated the capital gains exclusion. A tax attorney from Memphis, Robert W. Ratton, Jr., provided support for the retention of long-term capital gains in the tax code. In support of this argument he related to the Committee a history of industrial growth spurred by capital gains:

> In 1921 and since that time we have had, in one form or another, preferential treatment for long-term capital gains. There are several arguments in favor of the provision. One is to avoid taxing income earned over a period of years in a single year, or the "bunching" effect; a second is to avoid the disincentive for the disposition of property.
>
> The effect of preferential treatment is very industry-specific. The timber industry, the coal industry, the domestic iron ore industry, and the treatment of patents all receive special capital gains treatment. These provisions were drafted into the code during World War II and the post-World War II period to try to place timber and coal on a parity with other energy resources. And I think we must examine the effect of removing the capital gains provisions on these disparate industries before we just say that it is good to tax all income at one rate.

In Chicago, testimony was received from E. Patric Jones, president of the Urban Fund of Illinois, managing officer of Combined Opportunities Inc., and past chairman of the American Association of MESBICs (Minority Enterprise Small Business Investment Companies) who spoke on behalf of the venture capital industry. He noted how important the capital gains differential has been in encouraging investment capital in both new and existing businesses:

> When the capital gains tax differential was eliminated in 1969, venture capital almost dried up. Net new private capital invested in venture capital firms declined from $171 million in 1969 to $10 million in 1975. . .
>
> With the elimination of the capital gains differential, our industry invested $2.9 billion from 1970 through 1977, compared to $11.7 billion during 1978 through 1983, and for 1984 we think that number will exceed $3 billion.

Mr. Jones stressed the critical importance of capital liquidity to any economy as a whole, and urged the complete elimination of any tax on capital gains, noting that Japan and West Germany do not tax long-term capital gains, while the United States has the third highest capital gains tax rate in the industrialized world.

In Huron, South Dakota, William P. Anderson, president of Anderson Furniture, Inc., asserted that the health of certain segments

of the economy would be seriously damaged if capital gains were taxed as ordinary income:

> I feel that there would be less enthusiasm to purchase real property from the investment standpoint since part of the advantage of doing so could be wiped out. But more significantly, that risk taking in the high tech areas, which we need so badly, would be severely curtailed. New companies mean new jobs and correspondingly tax dollars from profits and personal incomes.

Even as the Administration reversed its policy on taxation of capital gains on May 28, 1985, the tenor of testimony continued to strongly support favorable capital gains treatment because of the critical importance of this issue to small business. This revision included a reinstatment of the capital gains exclusion, treating long-term investments even more favorably than under current law. The new plan would provide a maximum effective tax rate of 17.5 percent on the gains resulting from capital investments held over six months.

In Boston on July 3, 1985, John S. Buckley of Ernst and Whinney, presented the Committee with results of a survey his firm performed for the Small Business Association of New England (SBANE). Of the 2200 area respondents, 80 percent opposed elimination of the present treatment of capital gains:

> Our respondents seem to view the capital gains treatment as a means of obtaining additional capital investment for their businesses. These businessmen feel that corporate income taxes have already been paid on the earnings of their companies annually. They believe that their equity appreciation should be taxed, but taxed at a rate lower than the ordinary income tax rate.

At the same hearing, Frank Carroll, representing 35,000 members of the Small Business Service Bureau, noted the velocity with which investment dollars move through the economy based on favorable treatment of capital gains:

> The last time the tax rate was reduced under ERTA, millions of dollars were shifted from tax shelters to income-producing enterprises, spurring investment and stimulating the economy. . .

He also conveyed his association's disappointment with the lack of incentives for new business start-ups:

> We are disappointed, however, that there is no specific provision in the President's plan to help start-up and new businesses to encourage innovation or investment.

Other industry-specific concerns about capital gains taxation were heard from witnesses across the country. At the Committee hearings in Washington state, the timber industry's views on capital gains taxation were presented by Nels Hanson, president of the Washington Farm Forestry Association, who argued for the efficiency of the industry:

> The tax reform proposal discourages timber management. If I own a piece of land and I let it go wild and some timber does grow on it and I harvest the timber, then I could treat it as a capital gain. But if I manage the land and run it like a business, then you no longer treat any profit on the sale of timber as capital gains but you must then treat it as ordinary income. So it would discourage small landowners from managing their timberland to grow timber because if they don't, they get the benefit of capital gain on it.

In Fort Smith, Arkansas, Ned Purtle, a livestock breeder, expressed his concern about the elimination of capital gains treatment for Section 1231 assets, which includes breeding livestock:

> A cow which is held as a capital asset to produce calves as ordinary income is similar to a factory and should be eligible for capital gains treatment. Congress has long recognized a distinction for capital assets, such as breeding livestock, as opposed to business property held for sale.

A similar illustration of the inefficient decisions the tax code can induce taxpayers to make was offered by Bill Yager, a Montana farmer, who also called specific attention to breeding animals that are often sold as soon as they begin yielding litters, long before they reach maximum productivity:

> A lot of hog farmers sell breeding pigs after they've produced just one litter. Now, if you keep a sow for additional litters, she'll be more productive. Generally she'll produce better pigs and more of them.
>
> But federal tax code gives the favorable capital gains treatment to the breeding animals, while the return from market animals is ordinary income. [Thus farmers sell breeding stock earlier than economically practical in order to gain the tax benefits.]
>
> And so what you've got is the result of what's best for the farmer is probably not the most productive way to go.

Because the Senate Finance Committee version of H.R. 3838 proposed the elimination of the capital gains differential for individuals, effectively reversing the decrease in capital gains tax rates which had been approved in 1978, the Senate Small Business Committee felt it imperative to determine what impact such a radical proposal would have on the ability of small and emerging businesses to attract and retain capital. The fear among many members was that this proposal would disproportionately injure small, start-up businesses which have historically been dependent on venture capital firms and seed money from investors. Without preferential tax rates, would these funds still be available? The answer gleaned from the ten witnesses was an almost unanimous no.

Burton J. McMurtry, president of the National Venture Capital Association, noted that the reduction in capital gains tax rates in 1978 under the Steiger amendment had produced bountiful results: "significant creation of jobs, significant creation of additional tax revenues. Creation of productivity-improving products, improvements in exports, and a number of improvements in the general

quality of life." Eliminating the capital gains differential would send the wrong message to those investing in America's start-up and emerging small businesses:

> We really need a climate for entrepreneurship and innovation and further growth of companies that has been produced by the capital gains differential and by low rates and that we think can be continued by that.

Stanley E. Pratt, Chairman of Venture Economics, Inc., a research and consulting firm in Wellesley, Massachusetts, argued that the elimination of the capital gains tax differential would "be a major setback for the nation's business development process." He disputed the claims made by the Joint Tax Committee and the Senate Finance Committee that raising the capital gains rates would increase revenues to the Treasury Department. He noted that in 1978 when capital gains rates were in fact lowered, realizations went up significantly in subsequent years and the Treasury revenues increased dramatically. He added that the elimination of the differential would jeopardize the nation's international competitiveness. He added:

> The elimination of the differential is really a slap in the face of those who would create wealth and not a hinderance for the protectors of wealth. I think the elimination would hamper the social mobility for the many hundreds of middle-class people . . .

He also noted that total new capital committed to venture capital firms grew as a direct result of the lowering of capital gains taxes from about $10 million in 1975 to $3.3 billion in 1985.

Walter B. Stults, president of the National Association of Small Business Investment Companies, suggested:

> [T]he proposed removal of the capital gains tax differential threatens these valuable national economic assets. With significantly lower tax rates on ordinary income and with these higher tax rates on long-term capital gains, we are afraid that risk-taking, both by well-qualified business managers and by investors, would decline substantially . . . In addition, I am worried that the end of the differential would make risk investing far less attractives for the ordinary person.

While the rationale for elimination of the capital gains differential was a projected increase in revenues of as much as $220 billion, the Small Business Committee became convinced that revenues would not increase and could in fact decrease as a result of the elimination of the differential. To that extent, the testimony of Thomas Vasquez, Sr., president of Policy Economics Group and a former official with the Treasury Department was particularly relevant. He noted:

> I am estimating a revenue gain of $1.9 billion over the 5-year period from the Senate Finance bill. I have used conservative assumptions. I would not be surprised at all if the revenue effect was zero or negative. But it cannot be

possible for the number to be higher than $1.9 billion. That seems to be inconceivable.

The Committee was quite impressed with the near unanimity among witnesses at the hearing that the eliminating would have a pernicious, if not devastating, impact on small business, especially among venture capital firms. While the witnesses at the June 6, 1986, hearing were open on the Senate version of H.R. 3838 which did retain the corporate capital gains tax differential, their opposition would have been proportionately more vehement if the bill also proposed the elimination of the corporate capital gains tax differential, as did the final bill. In short, the Committee must reluctantly conclude that small business will not be benefitted, and will be seriously injured, by this change in our nation's tax code. It was in part in response to this threat that the Chairman voted against the bill on final passage, noting in a floor statement of September 27, 1986:

> The capital gains tax differential is a powerful incentive for investing in capital assets; it recognizes the greater risks undertaken by one who invests in the future, with all the inherent risks. It seeks to reward risk-takers by taxing them at a lower rate than if they had simply been receiving a stream of dividends or cashing in their paycheck. Our system thrives on such risk-taking and now we will upset all tradition in this country by telling investors they are no better off investing in as risky start-up than simply putting their money in blue chips.

Senator Boschwitz, a Committee Member, was attentive to the shortcomings in eliminating the capital gains differential and argued on the Senate floor that the elimination of the differential would put a penalty on capital and the accumulation of investment capital making it more difficult for businesses to expand. On October 9, 1986, he introduced S. 2916 to restore at least a partial capital gains differential.

Depreciation

Current law allows a deduction from income of a reasonable allowance for exhaustion, wear and tear, and obsolescence of property used in a business. This amount is determined by depreciation rules that distribute the cost (basis) of any tangible business property over its estimated useful life (recovery period).

Current depreciation rules, which are known collectively as the Accelerated Cost Recovery System (ACRS), were enacted in 1981 and somewhat modified in 1982 and 1984. ACRS applies to all property placed in service after 1980. The recovery periods for the five classes of property prescribed by this system are 3, 5, 10, 15, and 19 years. Under ACRS, generally accepted accounting methods, such as straight-line (proportional) or certain declining balance methods (such as 150 percent declining balance) may be used.

The Administration had initially proposed that ACRS be replaced with Capital Cost Recovery System (CCRS) which would assign depreciable property to six, rather than five, classes. Instead of permitting the use of any of several different accounting meth-

ods to determine allowable depreciation deductions, each CCRS class would be assigned a fixed declining-balance depreciation rate: 55%, 44%, 33%, 22%, 17% or 4%. The final version of H.R. 3838 which was passed by the Senate on September 17, 1986, maintained the basic substance of ACRS, but incorporated a number of changes in the length of allowable recovery periods. For example, most heavy machinery would be depreciable over a 7-year period as opposed to the 5-year period allowed under current law; commercial federal property currently depreciable are 19 years, residential real estate to a 31.5-year life.

Depreciation was among the most frequently addressed concerns by small business persons testifying at the panel hearings. The general consensus of witnesses was that small business has finally gotten accustomed to ACRS, and while still confusing, ACRS is not as complicated as it appears that CCRSL would be.

William F. Boyd, III, of Pacific Dye Casting Corp., offered the following comments:

> I feel this new system (CCRS) would complicate the concept of depreciation. A new set of rules now will not provide any more accurate picture of the correct amount of depreciation than the rules of the past.

Nona M. Brazier, president of Northwest Recovery Systems, Inc., Seattle, expressed her belief that neither CCRS (nor ACRS) has "any relationship to any day-by-day reality that the small business person can put his hands on." She favored a return to the old established standards of depreciation that served her so well before the Administration started to encourage investment with accelerated, front-loaded depreciation (cost recovery) systems:

> To deal with (CCRS), the small business person will have to hire someone to stay on top of all of the indices and alterations. Its complexity, while giving leverage to large businesses, works to the detriment of small businesses.

Mrs. Brazier also cited the complications with indexing feature of CCRS and with conversion to the straight-line method for depreciation when the assigned rate for the appropriate asset class yields less than the straight-line method.

The suggestion that the recovery lives of property simply be extended was offered to the Committee several times over the course of these field hearings. William F. Boyd offered the following:

> I suggest keeping the current ACRS depreciation rules, but possibly adjusting the rates to longer lives, if needed. This would provide the stability needed for compliance with the current rules, and would not further complicate the depreciation system being used.

Professor J. Burke Martin of the University of Montana noted that when Congress had enacted ACRS, it intended to forego tax revenues to encourage increased investment, particularly in machinery and equipment, with less emphasis on structures. This investment was intended to generate new jobs and increase productivity, and eventually increase Federal tax revenues.

Although not all comments heard by the Committee were negative towards CCRS, a large majority were. For example, Samuel R. Ludington, an accountant in Fort Smith, Arkansas, supported the Administration's CCRS proposal:

> ACRS depreciation is too fast . . . The President's proposal is nearer economic life and should be better than ACRS. Adjusting the annual depreciation deduction for inflation should help management provide the funds to continually update their plants and equipment . . . I feel that the indexing of deductions, after going through the inflationary spiral of the late 1970's is a necessity in our tax law.

The sentiment generally expressed by the majority of witnesses who testified at these hearings was that while ACRS is complicated, small businesses are becoming accustomed to it. Witnesses then indicated that if ACRS is not to be retained, at least some form of accelerated depreciation should be continued. Several witnesses suggested that if modifications were going to be made in ACRS, extending the recovery periods for different classes of assets would be the most preferable adjustment to make. Consequently, since the retention of ACRS depreciation with a few minor exceptions, was contained in H.R. 3838, from the point of view of most small businesses, the Tax Reform Act of 1986 is superior to the Administration's initial proposal.

Investment Tax Credit

The Investment Tax Credit (ITC) was created in 1962 to stimulate the economy by encouraging investment in durable assets. Generally, the ITC provides a credit against tax of 10 percent of any "qualified investment" in tangible depreciable property, excluding most buildings and their structural components. Investment in used property is eligible for the ITC in an amount of up to $125,000 a year.

The amount of the allowable ITC is proportionally less for investment in property with a useful life of less than 7 years. No ITC is allowable if the property has a useful life of less than 3 years.

For some specific kinds of property, the amount of allowable ITC is greater. For example, credit ranging from 11 percent to 15 percent of investment in various renewable energy generating property and geothermal equipment, a credit of 15 percent to 25 percent of expenditures for the rehabilitation of older existing buildings, is allowable.

Elimination of the ITC for all types of business investment was proposed in the initial Treasury plan of late 1984 and its proposed elimination was included in every version of H.R. 3838. To that extent, it was no surprise that the investment tax credit would be eliminated this year, although some feared that any reduction or repeal of the ITC might be made retroactive to some date in 1986 before the tax rate reductions were scheduled to take effect.

Those in favor of eliminating the ITC argue that it skews investment choices, creating an incentive for inefficient economic decisions. Many tax analysts have long been critical of the credit as producing no real inducement for investments in certain types of

property, but only rewarding taxpayers for what they do anyway. It is also maintained by many that elimination of the ITC would help simplify the tax code.

At the same time, businesses that invest heavily in capital assets and thus utilize the ITC, were opposed to the repeal of the ITC. Furthermore, many small businesses that utilize the ITC have long advocated a need to enlarge the amount of the ITC allowable for used property, which is often the only kind of property that many small businesses can afford to purchase. In fact, at the 1986 White House Conference on Small Business an overwhelming majority of the small business delegates voted to retain a section or the investment tax credit (see below).

Retention of the investment tax credit in any tax reform package was one of the major issues focused on by witnesses in each of the thirteen field hearings. The ITC is part of the larger "capital formation" issue for small business. Capital, whether it be through borrowed debt or equity investment, is frequently difficult for small business to obtain. Therefore, small firms must generally rely on earnings to generate the required capital for growth. The ITC is a mechanism which enhances cash flow by reducing tax liability, and has therefore become a particularly important source of capital to small businesses.

Eight of the ten witnesses at the Vancouver, Washington, hearing on August 16, 1985, focused on the importance of the ITC to small business. Elizabeth Sperline, a computer mainframe manufacturer and an importer/marketer of wines and spirits, presented her views on this issue:

> The elimination of the investment tax credit will be, in may estimation, the worst thing that could happen to small business.
>
> In an era when American businesses are faced with major international competition, I urge the administration and this committee to give strong consideration to retaining investment tax credits. We must continue to modernize American industry so we can compete in the world market. We cannot possibly pass along the costs of new plants and equipment to the consumer if we are to be competitive with foreign companies who are for the most part subsidized by their governments.

Darene Johnson, president of the Woodland Truck Line of Woodland, Washington, also urged the Committee to support retention of the ITC:

> Small trucking and other small business desperately need the investment tax credit. It is one area in which we save as much as the larger operations with whom we compete . . . I am not willing to trade the investment credit for a reduction in the top corporation tax rate. In case after case the investment tax credit is the deciding factor that makes a decision to purchase equipment cost effective for a small firm.

One suggestion offered several times to the Committee, as a way to save the ITC consistent with tax reform, was to limit the dollar

amount of investments which qualify for the ITC (as is the case currently with used property). The possibility of limiting the ITC strictly to domestically produced products was also suggested to help ameliorate our national trade deficit.

John Buckley of Ernst and Whinney presented the results of a survey his firm had been commissioned to perform of the 1800 members of the Small Business Association of New England (SBANE) and 400 executives of high-technology companies in the New England area to determine their views on the tax reform proposals. Mr. Buckley reported that 73 percent of the survey's respondents opposed elimination of the investment tax credit.

Joe Dooley of Wynne Equipment Company of Wynne, Arkansas, who also represented the Mid-South Farm Equipment Association, commented generally on the inability of farmers to compete internationally, to which the ITC is considered to be of substantial benefit:

> It is indeed ironic that a tax bill which promises to provide reductions in taxes for almost 80 percent of all individual taxpayers, substantially increases the tax liability of our nation's farmers who can least afford it . . . [by repealing the ITC]. Farm commodities represent a substantial portion of the country's exports, and with an increasing trade deficit, we cannot afford to increase the costs or reduce the efficiency of our nation's farmers.

Martin E. Tobin, chairman of the American National Bank of Chicago, whose customers are primarily small and mid-sized businesses, commented:

> Our industrialized economy, with its capital-intensive industries, will be hit particularly hard by this provision [to repeal the ITC]. It seems incongruous that Treasury wants to remove these incentives as they have been responsible, in part, for our improved economy.

One major complaint regarding the ITC is that business decisions are sometimes skewed to take advantage of the tax savings the ITC offers. Nona Brazier refuted this concern:

> The unanimous opposition to the ITC comes from the idea that business is being rewarded for purchases that it would make anyway presupposes that a business is established and able to update its equipment to become even more competitive within its market place . . . Small business does not have the luxury of making shrewd investment choices or inefficient economic choices based on tax policy; but the ITC has made it more economically feasible to make necessary business moves that would otherwise have had to go unmade.

Samuel R. Ludington, a C.P.A., reviewed the history of the ITC, noting that it was introduced in the early 1960s, twice since repealed ("suspended"), only to need to be reinstated (in 1967 and in 1971) to revive a stagnant economy, as well as two later increases in the ITC (in 1975 and 1981) for additional economic stimulation in particularly slow periods. He opined that each of these adjust-

ments to the ITC were Congressional attempts to stimulate the economy. He urged that serious consideration be given to the history of these changes and their positive effects on the economy, before abandoning the investment tax credit.

There was some acknowledgment of the necessity to reduce, if not eliminate, the ITC in order to fund the lowering of tax rates in the Administration's proposal. Indeed, tax rate reductions on the scale proposed in the Tax Reform legislation would have been impossible but for a substantial restructuring of the ITC, which is estimated to cost $147 billion in revenues over four years. To avoid an outright repeal of the ITC, a dollar amount limitation (as is the rule for used property) and limiting the ITC to domestically produced tangibles were frequently recommended modifications of the current ITC.

On the whole, small business witnesses strongly favored retention of the Investment Tax Credit, and emphasized its demonstrated effectiveness in stimulating productivity and business expansion.

Senator Weicker, in a floor statement to the full Senate on September 23, 1986, noted that the elimination of this "vital investment incentive" would only raise the cost of capital to small business and make it increasingly difficult for small businesses to afford the purchase of the latest "state-of-the-art" technology.

Corporate tax rates

Under current law, a graduated schedule of tax rates applies to corporate taxable income. The highest of the five corporate tax rates is a marginal rate of 46 percent, which applies to taxable income above $100,000. To illustrate the application of marginal rates, a corporation paying tax on a net income of over $50,000 but less than $75,000 currently pays a 30 percent tax on that portion above $50,000. However, the portion of earnings up to $25,000 is taxed at 15 percent. Similarly, the portion of earnings over $25,000 but less than $50,000 is taxed at 18 percent. Therefore, a company's effective rate of taxation is less than its marginal rate, except as explained later. Listed below are the five corporate tax brackets:

Taxable corporate income:	*Marginal tax rate (percent)*
0 to $25,000	15
$25,000 to $50,000	18
$50,000 to $75,000	30
$75,000 to $100,000	40
Above $100,000	46

The proposal originally presented by the Treasury Department in November 1984 applied a flat 33 percent tax rate to all corporate earnings. Subsequently, the Administration responded to strong objections from small business and from Congress and restored some of the graduation that was not in the original proposal. Under H.R. 3838, corporate income tax rates will be substantally reduced with the top rate lowered from 46 percent to 34 percent. There are two additional lower rates of 15 percent for the first $50,000 of income, and 25 percent for the next $25,000, up to $75,000.

The reduction of the top marginal rates on corporate income attempts to compensate for elimination of the many business tax credits and deductions that simplification requires. However, for those small businesses which pay at corporate tax rates, and which have low levels of taxable income, the reduction of the top two rates may not offset the elimination of deductions and credits that H.R. 3838 calls for. Base broadening, that is, the elimination of deductions, credits, and other preferences, expands the pool of income subject to tax, thereby permitting the lowering of rates. To measure the benefit of reduced rates, it is critical to recognize that these reduced rates are now applied to an expanded pool of income.

In order to better assess the impact of tax reform on America's 15 million small businesses, it would be useful to recall the business form in which the typical small business is organized and how it files tax returns. As mentioned before, small business corporate taxpayers currently represent approximately 20 percent of all small business entities. The remaining 80 percent of all small business taxpayers file individual returns as proprietorships, partnerships, or sub-chapter S corporations. Although small corporations comprise only one-fifth of all tax reporting small firms, these small business corporate taxpayers earn 65 percent of all small business net income. This business bias could explain why little concern was heard regarding tax rates for non-corporate businesses.

Bill Nourse, owner of Brookmead Hardware, Nashville, Tennessee and president of the American Independent Business Network, commented that "one of the items that concern me greatly is the concept of a flat rate." He continued:

> In principle it sounds very attractive; but in reality, for those of us that are in small businesses that are incorporated, you're really talking about a dramatic rate increase. For most small business companies my size, our profits are well under $100,000 a year.

The opinion was expressed by a number of small business persons that the Treasury proposal would actually be a tax increase for small businesses with earnings up to approximately the $160,000 taxable income level, particularly when one considers the loss of many preferences at the same time.

Gerald M. Kolb, treasurer of United American Food Processors, a meat processing firm employing approximately 100 people in the Chicago area, registered his objection to a flat corporate tax:

> Many small businesses are lucky to have $100,000 of taxable income and will now find that they are paying an increased tax cost at 33 percent. Small businesses above $100,000 are obviously going to have an additional tax burden of $7,250. Larger corporations can bear the brunt of this increased cost much easier than small businesses.

In addition, several small business groups, including the National Association of Wholesaler-Distributors and the National Retail Merchants Association, supported the retention of graduated corporate income tax rates. Testimony submitted by the National Retail Merchants Association noted that most of its membership, which averages a net annual income of less than $100,000, would be sub-

ject to a substanial increase in their tax liability with a repeal of current graduated rates to a flat 33 percent rate applied to all taxable income.

The National Association of Wholesaler-Distributors submitted the results of a study which demonstrated that a wholesale distribution or retail firm must have over $5,000,000 in sales ($5,161,000 by actual count) to be taxed at an effective rate of 33 percent under current law. This study reveals that:

> 94 percent (approximately 769,000 out of 816,000) reporting wholesale distribution and retail corporations fall below the $5,000,000 sales and, consequently, the 33 percent effective tax rate benchmark.

In response to these many outcries, and evidence of the adverse impact of the elimination of graduated rates, a concurrent resolution supporting the retention of the graduate corporate income tax rates was introduced in both chambers of the Congress on April 18, 1985 (S. Con. Res. 41). This resolution expressed the sense of the Congress on the importance of graduated rates to corporations. Senators Weicker and Bumpers were original co-sponsors, along with Senator Baucus and two Finance Committee members. Other Committee members who cosponsored this resolution were Senators Boschwitz, Sasser, Gorton, Boren, and Levin.

It should be noted that all of this activity took place before the Administration released its revised plan in May 1985, proposing to retain graduation of the corporate tax rates at income levels below $75,000. However, witnesses before the Committee continued to speak out on behalf of maintaining graduated corporate tax rates—even after the Administration changed its proposal—to ensure that graduated corporate tax rates would not be bargained away.

Frank Carroll, president of the Small Business Service Bureau, served notice of his membership's endorsement of the retention of graduated corporate tax rates:

> The graduated corporate tax rates are also much fairer to small firms than the Treasury's proposed 33 percent flat rate. Under the Treasury proposal, businesses with earnings under $100,000 would have seen their taxes double, while high-income businesses would have their taxes double, while high-income businesses would have enjoyed a 30 percent tax cut. Despite these positive cuts, certain aspects of the administration's plan could be adjusted to be of greater benefit to the nation's 7.2 million small businesses.

H.R. 3838 did in fact maintain the graduation of corporate tax rates, and to that extent it was responsive to a major concern expressed by witnesses at the field hearings.

In addition to the issue of graduated tax rates for incorporated small businesses, Senator Bumpers raised three other issues concerning the tax rate structure. On March 11, 1986, Senator Bumpers introduced S. Res. 364 (Record at S 2428-2431), which called for a reduction in the tax rates for incorporated small businesses with income of less than $25,000, retention of the current $1 million threshold for recapturing of the benefits of the graduated tax rate

structure, and retention of the current threshold for the maximum tax rate.

With respect to the first of these issues—tax rates for the smallest businesses—Senator Bumpers said:

> I find it hard to understand why every individual and corporate taxpayer will receive a reduction in rates except incorporated small businesses with less than $25,000 in income. Current law, the President's proposal and the House tax bill all would tax income of less than $25,000 at a 15 percent rate—in short, there is no reduction in tax rates for the smallest of businesses. Interestingly, under the recently adopted House tax reform bill, small businesses with income between $25,000 and $50,000 would receive a reduction in tax rates from 18 percent to 15 percent. The President would provide no tax relief for this income bracket, retaining the current 18 percent rate.
>
> With the rise in the standard deduction, under both the President's proposal and the House tax bill, all individuals directly or indirectly will receive a reduction in tax rates. Under the House bill, all corporations with income over $25,000 receive a reduction in tax rates and under the President's proposal all businesses with more than $50,000 in income receive reductions in tax rates. I cannot understand why the only group in the House bill are not receiving a rate reduction is the smallest of small businesses, those struggling small businesses with less than $25,000 in income. And I cannot understand why the President has proposed no rate reduction for any small business with income below $50,000

Unfortunately, in the final tax reform bill, no reduction was provided to these smallest of small corporations.

With respect to the second of these issues—the phaseout of the benefits of graduated corporate tax rates—Senator Bumpers said:

> Few people understand . . . that in 1984 the Congress adopted a measure which phases out the benefits provided for corporate rates for all corporations with more than $1 million in income. The way this is done is that for any corporation earning more than $1 million, an additional 5 percent corporate tax is imposed on income in excess of that amount. This surtax effectively recaptures the benefits of graduated corporate tax rates until a corporation has income of $1,405,000, at which point the surtax has recaptured all of the benefits of graduated corporate rates and all corporate income is taxed at the top bracket rate of 46 percent. This provision increased government revenue by $212 million in 1985.
>
> In his tax reform proposal the President would have this phaseout of graduated rates apply for all income in excess of $140,000—a drastic reduction in the current threshold of $1 million. Under his proposal the benefit of graduated rates would be denied to all corporations with income in excess of $360,000 and all income would be taxed at a flat,

> top bracket rate of 33 percent. The House tax bill proposed that this phaseout of graduated rates apply for all income in excess of $100,000—an even more drastic reduction. Under the House proposal the benefit of graduated rates would not be given to any corporations with income in excess of $365,000 would be taxed at a flat rate of 36 percent.

Again, however, the final tax reform bill provided no relief on the phaseout threshold. Indeed, the effect of the lower threshold—set at only $100,000 in the final bill—effectively denies to small corporations the benefits of lower tax rates.

Finally, with respect to the third issue—the income level to which the top bracket applies—Senator Bumpers explained:

> Under current law the top tax bracket rate of 46 percent applies to corporations with income above $100,000. The President would apply his proposed top bracket rate of 33 percent to all income above $75,000, thus, truncating the graduated rate schedule. Similarly, the House tax bill would apply its proposed top bracket tax rate of 36 percent to all income in excess of $75,000. This means that both proposals apply the top bracket rate to a much lower level of income, offsetting much of the benefits provided by the reduction in tax rates.
>
> To see what the House bill means, take a small business with income of $75,000. Under current law that small business is subject to a top marginal tax rate of 40 percent, but under the House bill that taxpayer would be subject to a 36 percent rate, a 4 percent reduction. However, a corporate taxpayer with $100,000 in income would receive a 10 percent reduction in its marginal tax rate—from 46 percent to 36 percent. The same inequity applies to small corporations earning $50,000 in income. Under current law these businesses are subject to a top marginal tax rate of 30 percent, while under the House bill they would be subject to top marginal rate of 25 percent rate, a 5 percent reduction. If the top marginal tax bracket applied only to income over $100,000—as is true under current law—these inequities in the benefits of rate reduction could be lessened substantially.

On this issue as well, the final tax reform bill provided no relief to small corporations.

H.R. 3838 is a rate-driven piece of legislastion with alluring maximum (effective) rates of 28 percent for individuals and 34 percent for corporations. These rates are most attractive for certain smaller businesses, including S-corporations, proprietorships, and partnerships—to all to which individual rates apply.

The structure of the rates in H.R. 3838 will be negative, however, at least for smaller corporate businesses. According to SBA statistics, while only 20 percent of all small businesses are taxed as corporations, this 20 percent earns over 65 percent of all taxable income (i.e., profits) earned by the small business sector. Also, as noted earlier, although the higher rates are significantly reduced,

the rates for smaller corporations are not reduced so substantially, quite possible not enough to compensate for the loss of many long depended upon tax preferences.

Industrial development bonds

Industrial development bonds (IDBs), also known as industrial revenue bonds (IRBs), are bonds issued by state and local governmental entities on behalf of private businesses to finance local industrial or commercial development projects. As a general rule, interest income earned on obligations of any state or local government unit is exempt from Federal income tax. Since 1969, however, interest income accruing to holders of IDBs has generally been subject to taxation, except for two specific categories of IDBs which have remained exempt from tax.

Provided that certain dollar limitations (generally $1 million, or $10 million if certain aggregation limits are met) and other requirements are satisfied, interest income from IDBs is tax-exempt if the IDB (1) qualifies as a "small issue"; or (2) if the proceeds are used to finance any of certain specified exempt activities, such as air and water pollution control facilities, sewage or solid waste disposal equipment, qualified mass commuting vehicles, or airports.

Despite many strong expressions of support at several of the 1985 field hearings for retaining the "small issue" exemption [IRC section 103(b)(6)], which was to expire after 1986 (except for manufacturing facilities and first-time farmers), H.R. 3838 provided no relief for most beneficiaries of the small issue exemption. H.R. 3838 retained current law, allowing the tax-exemption for most "small issue" IDBs to expire after 1986, and it only extended the manufacturing facility exception through 1989, rather than its 1988 termination date under the old tax law.

The restriction of this avenue of access to affordable long-term capital financing for expansion projects continues to be a major problem for small business. In some areas where any lending ability to small business is tied to agricultural operations, banks may not at this time be able to extend needed credit to small business. Several states and local governments have operated very successful programs to fill this credit gap by using tax-exempt small issue IDBs. With such affordable capital made available through IDBs, small businesses have been able to expand, thereby creating new jobs and generating added tax revenues for the economy.

Cash accounting

Another small business concern is the standard applied to use of the cash method of accounting. Under the cash method, revenue (money from customers for goods or from clients for services) is attributed to the period in which the money is actually or constructively received, while expenses are attributed to the period in which money is disbursed to pay an expense. Under the accrual method, revenue is recorded when it is earned, i.e., when a claim of right originates. In addition, expenses are recorded when a liability is legally incurred.

Legislating an exception for small businesses with low levels of annual receipts (e.g., less than $2 million) has been frequently proposed to enhance small business capital retention, as well as to re-

lieve such businesses of the complexity and expenses of accrual accounting. Most Committee members have consistently opposed any attempt to require accrual accounting of any small business, much less those businesses which provide services, such as attorneys, accountants, and other such professionals, where the necessary cash to pay expenses is often not immediately on hand.

The rule established by H.R. 3838 prohibits the use of the cash method of accounting with average annual gross receipts over the three preceding tax years of more than $5 million (except S corporations and personal service corporations, as well as partnerships with any such corporations as members).

The small business concern about any limitation of the case method of accounting is due to the anticipated complexity and paperwork burden a transfer to the accrual method will subject business to—all at no net gain to the profit margin of the subject business.

White House Conference

At the White House Conference on Small Business held in Washington between August 17–21, 1986, over 1800 delegates from throughout the United States were presented with some 600 recommendations collated from the state delegations and state conferences. The delegates pared down these recommendations to a final 60 which were presented to the Congress and the President for their consideration and action. Of those final recommendations, five of the top twenty-five concerned provisions in the tax code which were proposed to be changed by H.R. 3838. In some instances, the delegates voted to retain deductions or credits, which will be eliminated by H.R. 3838.

Recommendation number 12 provides;

A federal capital gains tax should be enacted which will provide savers and investors in an operating business with:

a. Deferral of tax on gain if proceeds are reinvested in a qualified operating business or an IRA account within 18 months.

b. A normal capital gains tax rate of 75 percent of the regular income tax rate for the gain if held for two years.

c. A special capital gains tax rate of 50 percent of the regular income tax rate if held for five years.

d. An entrepreneurial capital gains tax rate available only to a former or present founder or full-time manager-owner who has held the investment for at least 15 years with a step-rated favorable capital gains rate.

Any gain resulting from the sale of liquidation of a small business should qualify for tax treatment similar to a "lump-sum" distribution from a qualified retirement plan (i.e., ten-year average—five-year average proposed in H.R. 3838—or rollover to an IRA) or the tax on the gain may be deferred by reinvesting the proceeds of the gain in a qualified small business.

The benefits of Section 337 of the IRS code (otherwise known as the general utilities doctrine) should be retained. To explain, a corporation incurs a tax on the sale of its assets. Under the general utilities doctrine, the corporation avoids the tax on the sale or distribution of its assets to its owners in liquidation. A one-time tax is

incurred by the owner upon the receipt of the corporation's property instead of a double tax at the corporate and individual levels.

Recommendation number 16 provides.

The Investment Tax Credit should be retained, or restored for new and used equipment for small business (i.e., those businesses with fewer than 500 employees) and should be limited to end users of the property purchased. The tax credit should provide added incentive to domestically produced products.

Recommendation number 22 provides:

We recommend that the present law regarding cash basis method of accounting for tax purposes should be retained for all small businesses. The current tax code should not be changed regarding:

a. Use of a fiscal year.

b. Completed contract method of accounting.

Recommendation number 23 provides:

The current surtax exemption for corporations should be expanded to $200,000 per year, with a proportionate rate of tax as applied under current law to each expanded level thereunder, and a similar lower individual tax rate should be applied to business income derived from sole proprietorships, subchapter S corporations, and partnerships not engaged in passive income pursuits. These surtax exemption levels should be indexed to inflation.

The direct expensing provision should be increased to $150,000 to help small businesses retain capital for expansion. Also, inventories for small business should not include a requirement to capitalize wages, rents, or other overhead items.

Recommendation number 24 provides:

Congress should eliminate estate and gift transfer taxes on the transfer of small business assets to a family member. A family member is defined in 26 U.S.C. 2032A, and the entity should qualify as a small business.

Thus, it is clear that the delegates to the White House Conference considered advantageous tax provisions to be extremely important to their continued financial health, and were disappointed by a number of the provisions in H.R. 3838, although almost all approved the notion of lower rates. A number of small business representative groups expressed their opposition to H.R. 3838 for a variety of reasons. The Small Business Legislative Council, a permanent independent coalition of nearly ninety trade associations representing over four million small businesses, wrote on September 8, 1986:

> [A]fter the most careful of study and analysis, after continuing to provide constructive input into the process, and with a recognition of the need for self-sacrifice for the national good, we oppose this bill as undesirable for small business, as undesirable for the nation's citizens, and as undesirable for our collective national economy.

Small Business United, a national consortium of state and regional small business organizations, also concluded:

> After carefully analyzing the major components of the compromise measure, we have concluded that it is clearly an anti-capital formation bill because, among other rea-

sons, it eliminates the investment tax credit, terminates the highly favorable ACRS provisions enacted only five years ago, and most importantly, eliminates the capital gains differential which has been largely responsible since the initial 1978 rate reactions for stimulating the largest small business boom in the last fifty years.

The National Association of Small Business Investment Companies also opposed the bill because:

The National Small Business Association also opposed H.R. 3838 and noted, "The measure will in our opinion adversely impact the competitive position of small business. Equally important, it will severely inhibit small business's ability to bulwark our national economy."

Chapter IV. Liability Insurance Crisis

The high cost and unavailability of liability insurance coverage for small businesses reached crisis proportions during the 99th Congress. Many companies were forced to limit production, cease hiring and eliminate services that were vital to the economy because they could not obtain or afford property/casualty liability insurance coverage. Shockingly high numbers of small firms reported they were "going bare", operating without coverage, or shutting down entirely. Hundreds of letters to the Senate Small Business Committee, from small firms all over the nation, reported premium increases from 50 to 1500 percent, mid-term cancellations, and nonrenewals. Many firms expressed the concern that the insurance industry cared little about the fate of small business during this crisis and urgently asked for Federal intervention to rectify the problem. Others voiced strong support for total overhaul of the civil justice system and massive tort reform by Congress.

Historically, the property/casualty insurance market has been cyclical. According to insurance industry representatives, the recent increases in insurance rates are the result of record losses suffered in 1984 and 1985. Although exact figures have not been presented, the insurance industry cites large jury awards as the cause of its record losses. The industry advocates modifying state tort laws in order to make the risk assessment in certain lines of business more predictable and, therefore, insurable.

On the other hand, trial lawyers and insurance consumer advocates strongly feel that the insurance crisis is the result of poor management and "cash flow" underwriting by the industry. They say insurers cut their premium rates when interest rates were high back in the late 70's and early 80's in order to generate greater income from investments. However, claims paid out by the industry since that time have greatly exceeded the dividends from investments.

The liability insurance issue was voted the number one priority of the 1823 delegates at the White House Conference on Small Business (WHCSB) held August 17–21, 1986, in Washington, D.C. The Conferees asked that the President, Congress and state legislatures make sweeping reforms in the civil justice system as well as review and revamp certain insurance industry practices. Their recommendations included:

Civil Justice Reform:

(1) Return to a fault-based standard of liability.

(2) Base causation findings on credible scientific and medical evidence and opinions.

(3) Eiminate joint and several liability in cases where defendants have not acted in concert.

(4) Limit non-economic damages (such as pain and suffering, mental anguish or punitive damages) to a fair and reasonable maximum dollar amount, not to exceed $250,000 in any case.

(5) Restrict punitive damage awards to cases of willful and malicious conduct. The amount awarded shall go to a governmental trust fund, not the plaintiff.

(6) Limit attorney's contingency fees to reasonable amounts on a sliding scale.

(7) Reduce awards in cases where a plaintiff can be compensated by certain collateral sources to prevent windfall double recovery.

(8) The prevailing party in a legal action should have a statutory right to recover his costs and attorney's fees from the non-prevailing party.

(9) Impose uniform and reasonable statutes of limitations and repose in all tort actions, and hold defendants liable only for state-of-the-art technology in existence at the time the product was manufactured or the service was performed.

(10) Provide for periodic, instead of lump sum, payments for future medical care or lost income.

(11) Encourage use of alternative dispute resolution mechanisms to resolve cases out of court.

Federal Standards for product, professional and commercial liability:

Establish a uniform standard of fault for product, commerical, and professional liability which incorporates provisions cited in "Civil Justice Reform" above.

Availability and Affordability of Liability Insurance and Re-Insurance:

(1) Review McCarran-Ferguson Act of 1945 as it applies to state regulation of insurance and the industry's limited exemption from antitrust laws.

(2) Promote the establishment of joint underwriting associations and assigned risk pools.

(3) A minimum of 60-days notice should be required for an insurer to non-renew a policy or to increase its unit premium by more tan 25 percent. Mid-term cancellations should be prohibited and premiums should be based on experience ratings.

(4) Promote tax deductible self-insurance through risk pooling and other group arrangements, including the expansion of the Risk Retention Act of 1981.

(5) Legislate a self-insurance system that would allow small businesses to pay premiums into a fund with pre-tax dollars which could be used for no other purposes than the payment of claims, with the fund being regulated in the same manner as any other insurance company.

(6) Require the insurance industry to make complete financial disclosures by lines of insurance, so that Congress, state legisla-

tures, and state insurance commissioners may call on it at any time.

Education:

Realizing that the most effective long-term solution to the liability insurance problem is a knowledgeable citizenry, we urge an ongoing education program to develop an awareness that:

(1) The litigious nature of the American public will profoundly affect our way of life as the cost of public and private facilities becomes unaffordable.

(2) There is no such thing as a riskless society, so each of us must assume some responsibilty for his/her own safety and the normal hazards of everyday living.

Committee Hearings

Six field hearings were held by Committee members in the states of Tennessee, South Dakota and Wisconsin from November 1985 through May 1986. In addition, two days of liability insurance hearings were held in Washington, D.C., on February 20 and 21. Chairman Weicker presided over the hearings with Senators Kasten, Pressler and Bumpers alternating the chair according to schedule damands.

The hearings revealed the intensity of the affordability—availability problem and its effect on a wide range of small businesses, from day care centers to chemical companies and from certified public accountants to sporting goods and other produce manufacturers.

A summary of the testimony of some witnesses describing the dire straits of their businesses follows:

Manufacturers, day-care centers and pharmaceutical firms with few or no claims filed against their organization or products received last minute cancellation notices for no just cause.

Judy Silverman, Co-director, Jackson Child Care Program, Inc., New Haven, Connecticut, testified:

> The availability of general liability insurance has been a serious problem for us. Our insurance policy was cancelled out of hand last year . . . We scrambled around to find other coverage. The increase was 634 percent . . . Next month [the premium] will increase 1500 percent over the original costs. Our umbrella policy was cancelled and we have not been able to find anything to replace it at any price. . .

Ms. Silverman further stated that her agency had no claims filed against them and that according to research data day care was not a high risk business. She felt that insurance companies had unjustly cancelled policies for child care.

William Brine, President, W.H. Brine Co., Milford, Massachusetts, manufacturers sporting goods and equipment. His small company is a major manufacturer of lacrosse helmets and other equipment. Mr. Brine stated:

> . . . Two years ago I paid $8,000 for 25 million dollars worth of liability. Last year, at the last minute, 4:45 on Friday, I was told I had to make my decision whether I

> wanted the insurance or not; and my cost was $80,000. I was told I had 15 minutes to make my decision—by 5 o'clock. We paid the $80,000. Now, this year they want to charge me $200,000 for 1 million dollars worth of coverage for a claims-made policy.

Mr. Brine indicated that he could not pay the premium, which would not have provided adequate coverage anyway, and he was "going bare". He added that there were only two manufacturers of lacrosse helmets left in the country and that another lawsuit would destroy the industry.

Mr. Brine blamed a runaway tort system and lack of fault-based uniform standards for product manufacturers as the major cause of the crisis.

Organized youth sports, camping activities, and interscholastic high school sports throughout the country were in serious jeopardy because insurance companies refused to write policies that covered their risks while actively involved in play.

According to testimony submitted for the record by Maria Dennison, Vice President, Sporting Goods Manufacturers Association:

> The product liability problem has the potential to kill amateur youth sports in this country. We are now seeing many schools having difficulty in obtaining liability insurance. As a result, they are eliminating their school sports programs. This has a devastating effect on the institutional market of our manufacturers, and the opportunity for kids in America to participate in sports.
>
> The U.S. National Park Service is presently reviewing all of its contracts with concessionaires. High risk outfitters like canoe, raft and horseback providers are finding insurance both unavailable and unaffordable, as are ski areas.
>
> The result: potential suspension and bankruptcy of small businesses.
>
> Nurse-midwives cannot find coverage, at any price, in most locations in the U.S.

Karen Ehrnman, Coordinator of Government Relations, American College of Nurse-Midwives, Washington, D.C., testified:

> . . . Since last July certified nurse midwives have been without a blanket professional liability insurance policy . . . the loss of insurance had nothing to do with performance or the rate of claims against nurse-midwives.

Ms. Ehrnman further stated that of the 2,500 certified nurse-midwives practicing in all 50 states, only 6 percent had ever been sued, compared to 66.9 percent of regular practicing obstetricians. Ms. Ehrnman was desperately seeking legislation that would allow members of her group to self-insure or form a risk retention group since traditional insurance coverage was almost totally unavailable or unaffordable to nurse-midwives in most of the fifty states:

> Small trucking firms and firms that transport hazardous waste cannot find coverage nor can they afford the mini-

> mum level of insurance coverage required by EPA and DOT.

Mr. Jerry Wheeler, Executive Director, South Dakota Truckers Association, in a field hearing chaired by Senator Pressler, stated:

> One thing that is extremely unique about our industry is the fact that State and Federal Governments dictate the levels of insurance coverage that our members must carry . . . Insurance companies are refusing to write coverage altogether in some cases, and pricing it out of reach in others. We are caught between trying to comply with laws that say what coverage we must have versus not physically being able to do it.

Mr. Wheeler further stated that tank truck carriers hauling hazardous material could not get coverage at any rate and that a major carrier in South Dakota whose insurance rates were in the 1,000 percent range had gone out of business. He felt that some insurance companies were arbitrarily and unjustly cancelling policies mid-term or without prior notice.

Commerce Committee Actions

In the mid-1970's, the business community and other concerned observers were of the opinion that product liability had become a severe interstate commerce issue, one which needed a federal response. The dramatic rise in product liability claims and litigation costs as well as increases in product liability insurance premiums formed the basis for this opinion.

In 1976 a Federal Interagency Task Force on Product Liability chaired by the Department of Commerce (DOC) was formed to tackle the problem. The Committee conducted an 18-month study which confirmed the business community's concerns that the issue had reached crisis proportions in terms of increases in insurance premiums and product liability litigation.

A second task force was formed by DOC in 1978 to develop options and recommend actions, if any, the Federal government should take to address the product liability problem. The task force's report stated that the patchwork and laws or rules that governed civil actions across the 50 states were such a "hodgepodge" that insurance rates could not be set with any degree of constancy. It was recommended that a model product liability law be drafted for implementation at Federal or state level. This model law was promulgated during President Carter's term in office, but was adopted by only a few states.

A similar problem of insurance availability and affordability again erupted in the 80's but with even greater intensity in terms of cancellations, skyrocketing premiums and soaring litigation costs. In response, in 1985, the U.S. Attorney General established a Tort Policy Working Group consisting of senior Administration officials from eleven agencies. The Working Group's report, "The Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability", recommended a number of tort law changes for product liability applications and served as the basis for the two major pieces of legislation that were successfully

reported out of the Commerce Committee during the 99th Congress.

Legislation

S. 2129, the Risk Retention Act Amendments of 1986, passed in the Senate on July 17 by a vote of 96–1. The bill amended the Product Liability Risk Retention Act of 1981 and allows businesses, associations, municipalities and other groups, in addition to product manufacturers, to self-insure or join purchase groups in order to obtain premiums at reasonable rates. Chairman Weicker joined Commerce Committee members as an original co-sponsor of the bill because he felt it would bring a degree of relief to some small businesses that were unable to obtain or afford certain lines of insurance coverage.

Final passage of the bill, with amendments, took place in the House on September 23, with the Senate passing the amended bill on October 6. "The Risk Retention Act Amendments" bill was signed into law by the President, as P.L. 99–563 on October 27, 1986.

S. 2760

On June 26, 1986, after many months of hearings and negotiations, the Senate Commerce Committee reported out by a vote of 10 to 7 an original bill, S. 2760, the Product Liability Reform Act, which replaced the former bill, S. 1999. The new bill provided a number of limitations on liability, added protection for the product seller and strong incentives for the plaintiff and defendant to reach early settlement. Due to several controversial provisions, however, the bill was subjected to a filibuster by a few Senators who opposed the legislation and refused to allow the bill to be fully debated. One of the most controversial aspects of the bill—the language that placed caps on pain and suffering awards and dignitary losses—was replaced by a bipartisan agreement removing all caps, but the change did not create enough additional support for the bill to allow further debate on the merits.

Because of a crowded schedule, Majority Leader Dole decided not to proceed to debate the bill, even after the overwhelming vote to do so. The 30 hours which might have been needed for product liability debate would have made it impossible for the Senate to deal with other priority bills such as the Continuing Resolution, Tax Reform, Reconciliation, and others which had to be acted upon by the adjournment date which was imminent.

General provisions of S. 2760, As Reported:

Established a settlement procedure which created incentives for both plaintiffs and defendants to settle claims within a short period of time (60–90 days) after a suit is filed; both plaintiffs and defendants would be allowed to make settlement offers.

Made a product seller liable only if negligence were proven, except where a manufacturer was determined to be judgement-proof.

Provided that punitive damages be awarded only if the plaintiff established by "clear and convincing evidence" the defendant's "conscious, flagrant" indifferences to the safety of those persons

who might be harmed. If a defendant willfully destroyed or withheld relevant information, this defense was not applicable.

Provided a two-year statute of limitation for filing complaints, which did not begin until the claimant discovered both the harm and its causes.

Provided a statute of repose, to bar liability of manufacturers of "capital goods" where harm occurred twenty-five years after the product was manufactured, and to bar the liability of manufacturers of "consumer goods" where harm occurred after the "useful safe life" of the product, presumed to be ten years.

Placed penalties on attorneys for filing frivolous lawsuits and causing delays, holding them liable for costs resulting from delays and inappropriate actions.

Required any party who was or would be involved in a product liability action to retain all relevent material or be subject to a fine.

Damages awarded in a product liability action would be reduced by any worker's compensation benefits; the employee subrogation lien was eliminated in all states, except Washington.

Limited the application of joint and several liability. (Modeled after California proposition 51 which makes defendants jointly and severally liable for economic damages, but only proportionately liable for non-economic damages).

Created a presumption that when a foreign plaintiff suffered a product-related injury overseas, the claim should be brought in a foreign jurisdiction, rebuttable only by clear and convincing evidence.

Prohibited plaintiffs from recovering damages if the cause of their injury was primarily the result of being intoxicated or on drugs.

Prohibited the award of punitive damages against companies that had complied with Federal Drug Administration or Federal Aviation Administration regulations.

Required product liability insurers to report dates to the Department of Commerce concerning industry profits, investment earnings, legal expenses, and jury awards.

Two amendments surfaced after the bill was reported out of Committee:

A. The Kasten/Lugar/Kassebaum Amendment which would establish a fault-based standard of liability to render products manufacturers not liable for harm caused by an unreasonable or unforseeable use or alteration of a product; or for harm caused by a defect in a product or failure to warn about the defect, if at the time of manufacture knowledge of the defect was not reasonably available or obtainable through existing scientific, technological or medical information.

B. The Pressler amendment on joint and several liability which would limit each defendant's liability for both non-economic and economic damages to the percentage of responsibility rather than the ability to pay ("deep pockets" theory). The Committee's reported bill included this limitation only for *non*-economic damages.

Summary

The Senate Small Business Committee has been actively involved throughout the 99th Congress with liability insurance issues. As stated earlier in this report, the impact of insurance cost and unavailability has had a devastating effect on small business making it clear to all Committee members that legislation must be promulgated with haste to bring relief to the many thousands of small businesses threatened by this crisis. Chairman Weicker encouraged bipartisan participation of Committee members in holding hearings in their respective states. In addition, five members of the Small Business Committee are also members of the Commerce Committee, a factor which also encouraged interaction by the Chairman and his staff with those Senators and their respective staffs in seeking solutions to the liability insurance problem.

The successful reporting by the Commerce Committee of two major pieces of legislation during the 99th Congress was no small feat. It is a fact that, with the exception of the Product Liability Risk Retention Act of 1981, no major piece of product liability legislation has survived over a nine-year period and the scrutiny of six congressional Committees until the favorable Senate votes for S. 2129 and S. 2760 in the latter months of the 99th Congress. As noted *infra*, S. 2129 received approval of both houses and was enacted into law in October 1986.

Having been voted the number one issue of the White House Conference on Small Business, as well as as the top priority of many associations representing businesses throughout our nation, such as the National Federation of Independent Business (NFIB) and Small Business United (SBU), it is more than likely that liability insurance legislation will be an early agenda item for the 100th Congress.

Chapter V. Innovation and Technology

During the 99th Congress, the Subcommittee on Innovation and Technology monitored the implementation of the Small Business Innovation and Development Act, P.L. 97-219. Several hearings were held to review the program, and as a result of these oversight activities, language was placed in agencies' appropriation bills and legislation was enacted to reauthorize the program.

The Small Business Innovation and Research (SBIR) Program requires each agency with a research and development (R&D) budget of a $100 million or more to establish an SBIR program within the agency. Small Businesses are then invited to submit proposals in response to Agency solicitations which are released by the various SBIR offices.

Twelve agencies participate in the SBIR program. They include the Department of Agriculture, the Department of Commerce (DOC), the Department of Defense (DOD), The Department of Education, the Department of Energy (DOE), the Department of Health and Human Services (HHS), the Department of Interior (DOI), the Department of Transportation (DOT), The Environmental Protection Agency (EPA), the National Aeronautic and Space Administration (NASA), the National Science Foundation (NSF) and the Nuclear Regulatory Commission (NRC).

Funding for the SBIR program is mandated by the Act to be a percentage of each agency's extramural R&D budget. In FY 1985 each agency was required to set aside 1.0 percent, and 1.25 percent for each fiscal year thereafter. DOD, however, was allowed to reach the 1.25 funding level by FY 1987.

The program is divided into three phases. In Phase I small firms can receive up to $50,000 for a R&D proposal which has scientific and technical merit. In Phase II recipients of Phase I awards can receive up to $500,000 over a two-year period to further develop a proposal which has demonstrated significant scientific and technical merit. The third phase pursues the commercial application of the R&D, and may involve non-SBIR funded production contracts with a federal agency or private sector financing.

Through the first three years of the program, approximately $356 million in R&D funding have been awarded to small, innovative firms for Phase I and Phase II experimentation. Award winners have represenated 46 states and the District of Columbia, and the distribution of R&D proposals has fallen within the following areas of technology: computer, information processing and analysis; electronics; materials; mechanical performance of vehicle weapons facilities; energy conversion and use; environment and natural resources and life sciences.

Investigation

During the first session of the 99th Congress, the Subcommittee on Innovation and Technology launched a six-month investigation to examine the implementation of the SBIR program at the National Institutes of Health (NIH) in the Department of Health and Human Services. The Small Business Administration (SBA) and members of the small business community had expressed concern that small businesses were being discouraged from participating in the agency's program, insofar as NIH published vague solicitations, required cost-sharing, and used an omnibus solicitation format similar to its traditional R&D grant program, which also caused the agency to exceed the six-month limitation for the evaluation and award process.

It had also been suggested that the set-aside provision forced NIH to fund proposals of a lower quality than it would under its traditional program, resulting in a suboptimal allocation of the agency's resources. Because NIH maintains the second largest SBIR budget, Senator Rudman, Chairman of the Subcommittee, and Chairman Weicker, who also chairs the Appropriations Subcommittee on Labor, Health and Human Resources, thought it was imperative that these issues be resolved to ensure that the innovative potential of small businesses was properly tested and that the integrity of NIH's research mission in the biological sciences was not jeopardized.

Committee staff met extensively with representatives from NIH and SBA to discuss the agency's implementation of the program. Following these meetings, a provision was placed in Senate Report 99-151, the Department of Health and Human Services and Education Appropriation Act for FY 1986, reflecting the agreement reached by the parties. The provision appears at page 57:

The Committee notes that the NIH Small Business Innovation Research (SBIR) Program maintains the second largest budget mandated by P.L. 97-219. The Committee is aware of the concerns expressed by the Small Business Administration and small firms participating in the program with respect to NIH's implementation of P.L. 97-219. While NIH has improved its efforts in this regard, still greater achievement can be expected as NIH continues to build relationships with the community of research-oriented small businesses and to refine SBIR procedure. The Committee expects that the Director will provide strong central management and representation for the SBIR Program, and the Director will be responsible for ensuring that special emphasis by given to the following objectives: (1) SBIR applicants are to be notified of funding decisions within six months of each receipt date for SBIR proposals; (2) small business proposals of the highest quality are funded by monies set aside for the SBIR program by adjusting the distribution of grant applications to the maximum extent possible; and (3) NIH ensures uniform SBIR administrative practices across the participating awarding units. The Committee directs that these objectives be realized during the 1986 fiscal year.

Committee's Oversight of Act

The agencies and the small business community have been extremely supportive of the SBIR program. Senator Rudman, Chairman of the Subcommittee on Innovation and Technology and the original author of the legislation, conducted two oversight hearings in March 1986. Of particular interest to the Subcommittee was the examination of the Phase II component of the program. Since one of the objectives of the act is to increase private sector commercialization of innovation derived from Federal R&D, an examination of the first generation of Phase II results would provide the Subcommittee with a preview of the kinds of proposals being funded by the program. During these hearings, representatives from the agencies, the small business community and state government testified before the Subcommittee regarding their experiences with the SBIR program.

The first hearing was held in Merrimack, New Hampshire, on March 3, 1986. The Honorable John Sununu, Governor, State of New Hampshire, gave an economic overview of the role small businesses play as a critical resource at the state level:

> The data in our own State is very impressive, not only in terms of what small businesses contribute directly via the R&D mechanism, but in terms of their basic contribution to the economic strength of this State. Ninety-five percent of the economic expansion and job opportunities within this State in the last last 3 years has come from businesses that fall in the category of the small business definition. Ninety-five percent of the growth in jobs has come from that area. Ninety-five percent of the potential

that we see for additional expansion will continue to come from small business.

We hope that they have continued access to all the resources that are available through Federal programs as well as the area that they generally do quite well in where they compete in the private sector.

One of the small firms that has won multiple awards from various agencies in Creare of New Hampshire. Creare is a mechanical engineering service company and computer software products company dedicated to technological advances in a variety of mechanical engineering areas. Dr. James A. Block, President of Creare, informed the Subcommittee of one of the firms completed Phase II projects which was near commercialization:

I would like to give an example of how the SBIR Program has benefited us and talk about one of the Phase 2 projects we have recently completed. This was a project performed for the Department of Energy to develop a very unique pump which would pump cryogenic fluid, basically pump or compress very cold helium.

The basis device has a number of applications, including magnetic refrigerators for space, transfer of hydrogen in space for NASA, and the specific DOE application which involved cooling of superconducting magnets for high energy physics experiments.

We developed a unique pump which is extremely reliable, which has a long life, low maintenance and, most importantly, is non-contaminating of the helium. We did this by hermetically sealing the pump unit and using the cryogen itself for lubricating the bearings.

Fermi Lab is a laboratory in Illinois which has the United States' largest superconducting magnet facility to accelerate particles to very high velocities for basic research. They have an in-place investment in these magnets of over $1 billion. The hope is, and our expectation is, that by putting a number of these pumps we have developed around their loop of magnets, they can achieve a 25 percent increase in the energy levels available at this facility which will provide a very cost effective way of maintaining the U.S. leadership in high energy physics.

At the March 23rd hearing in Washington, DC, Dr. Ernest L. Koerner, President of TECHRAD, Inc., of Oklahoma, testified to the objective of his firm's innovation entitled "Pilot Plant Investigation of Coal-Wood-Pellets as an Industrial Fuel Source", which received Phase I and Phase II funding from the Department of Energy:

There are several important benefits that can be derived from the successful application of the proposed technology. The most important benefit to be derived from this effort is that it would utilize coal and wood wastes as an industrial fuel. Coal finds and sawdust are now largely wasted natural resources because of a lack of technology to put them into a marketable form. The available large tonnages

of these wastes provide private enterprise with profit-making opportunities and, at the same time, allow certain industries to stabilize their energy bills with lower-cost fuel.

The utilization of coal fines derived from secondary recovery operation offers the potential to conserve an equivalent amount of virgin coal for future generations. In addition, by furnishing a cheaper fuel source than oil and gas, these natural resources are also reserved for future use. It is especially important at this time to replace as much oil usage as possible to reduce the nation's dependence on imported oil.

Another interesting innovation developed under the program is that of David Franklin, who is President of Audiological Engineering Corporation in Massachusetts. Mr. Franklin's firm has received Phase I and Phase II funding from the National Institutes of Health for the firm's development of wearable tactile aids for the profoundly deaf. According to Mr. Franklin, Audiological Engineering is one of two domestic firms and one of six world wide to have developed this hearing device, both of which have received SBIR funding. Mr. Franklin shared with Members of the Subcommittee how the program has benefited the firm's work in this area:

Because of this relatively small market potential, it is highly unlikely that sufficient research and development funds could have been found without the SBIR Program. Without the continued support of the SBIR Program it is equally doubtful that the tactile technology will be able to attain its full potential.

In my mind it is very important to address the trend of today's society towards invasive treatment of human ills. The treatment of profound deafness by non-invasive tactile methods is an attractive and inexpensive alternative to cochlear implants which are both invasive and expensive.

One of the most rewarding aspects of this work has been feedback from teachers and parents of profoundly deaf children. They have consistently reported significant improvements in previously unresponsive children as to speech quality and frequency, responses to environmental sounds and an awakening of interest in lip reading, signing and social interaction.

Formal studies with two children, Megan (from 29 months to 44 months), and Tabitha (from 33 months to 43 months) have shown remarkable results. The older child, (Tabitha, now 12 years old), is mainstreamed, completely successful academically, and a social leader among her hearing peers. This is a very unusual outcome for a profoundly deaf child.

The other child, Megan, now 5, is showing language acquisition rates, both receptive and expressive, that fully match those demonstrated by Tabitha. Megan was the subject of a nationally shown TV special on PBS (New Tech Times).

In response to a question posed by Senator Kerry, who cochaired the hearing, Mr. Franklin stated that about 400 to 500 children are using this tactile aid. He also testified the potential savings from the use of the aid by this group would be 10 times more than the $500,000 that will be spent over a 20-year period to mainstream them in society.

These were just a few examples of some of the innovations being funded, all of which would never have been realized without the SBIR program. While it is too early to predict the overall impact the program will have on the economy since most of the innovations can take anywhere from four to 19 years to reach commercialization, Members are confident that these and other small business innovations will make a vital contribution to this nation's technological base.

Another objective of the SBIR program is to strengthen the role of small business at meeting federal R&D needs. Each of the twelve agencies participating in the program were also asked to submit testimony on their second year results under the program. Given the fact that opponents of the program thought the set-aside provision would result in a "suboptimal allocation of resources", Members of the Subcommittee were particularly interested in receiving the agencies' comments to assess how small firms are responding to their individual R&D needs.

Dr. William F. Raub, Director, Office of Extramural Research and Training, National Institutes of Health, made the following statement concerning the SBIR Program:

> Having described our first three years' experience with the SBIR Program, we would like to bring the Subcommittee up to date on an issue that has been the subject of some interest and speculation: the quality of the research funded by the DHHS and particularly the NIH SBIR Program. In FY 1984, the second year of the program, the NIH SBIR set-aside funds more than tripled from the previous year, going from $6.07 million to $20.7 million. That year the number of grant applications submitted to NIH did not triple. Consequently, in a few institutes at NIH, specifically the National Cancer Institute (NCI), all approved grant applications, regardless of score, were funded. This led to the well publicized case of a grant application with a score of 349 that was funded by NCI. (Priority scores range from 100 to 500. One hundred denotes the highest and 500 the lowest scientific merit of an application recommended for approval.) Since then the quality of SBIR applications has improved significantly as the numbers have continued to grow. The SBIR mean score of 250 compares favorably with the mean score of 227 for NIH regular research grant applications. While the average quality of SBIR grant awards, as reflected strictly by score, appears to be slightly lower than that of our regular grants, last year some institutes, e.g., the National Eye Institute, the National Institute of Child Health and Human Development and even the National Cancer Institute, funded SBIR applications with scores essentially equiva-

lent to those funded in their regular research grants program. Thus we are confident that the quality gap between NIH SBIR awards and traditional project grants is proving to be evanescent.

Another agency that echoed the same sentiments was NASA:

> Since the enactment of the SBIR statute, NASA management and researchers have developed a strong support of and enthusiasm for the program. NASA has found that a great number of new and attractive approaches to problems and opportunities identified in the program solicitation have been offered by a large number of innovative small firms. Most of these ideas had not previously been volunteered to NASA by those firms, and possibly would never have been in the normal course of events. The SBIR opportunity and stimulus made it possible for many of these ideas to reach NASA's attention and to be funded. Of course, a number of the proposals received the first year and in subsequent years were judged not to have great merit; nevertheless, we were greatly pleased with the high incidence of high-quality, thoughtfully developed R&D proposals.
>
> One conclusion, based on 3 years of experience in the program, is that the SBIR Phase I-Phase II approach and program management philosophy have provided a very cost-effective means for exploring new ideas rather quickly. The rapid response capability of our SBIR firms and their generally high motivation and skill levels have proved to be genuine assets in our overall program. SBIR contract efforts are now viewed as an integral and important element of the overall NASA R&D program, albeit comprising a relatively small total increment. Among the SBIR projects are the development of new analytical methods, designs, software, and hardware for direct use by NASA in our total R&D and operational program activities.

These comments were neither peculiar to NIH nor NASA. The remaining ten agencies also submitted similar comments and voiced their staunch support of the program.

In addition, state officials from New York and Pennsylvania testified that their states have either established or are in the process of developing a prototype to the federal model, as a method of fostering economic development at the local level. New York has done just that. On July 19, 1984, the New York State Small Business Innovation Research Promotion Act was passed and signed into law by Governor Cuomo. The legislative intent section of the statute best summarizes the reasons behind New York's SBIR program:

> The Legislature finds and declares that it is in the best interest of the state to increase participation by New York small businesses in the federal small business innovation research program and to assist New York small businesses in becoming SBIR Phase II grant recipients. Small technology-based firms are the source of approximately one-half of

our nation's major innovations. By implementing a promotion and matching state program in this legislation, the state can encourage the formation, growth and development of small, innovative high technology companies in the state and contemporaneously stimulate high risk or advanced technology research and development by New York small businesses which potentially could lead to commercialization of new products and processes. Such a program which encourages existing high technology companies to remain and expand in New York creates expanded employment opportunities and assists in the growth and development of the economy of New York.

Approximately nine oversight hearings were held on the SBIR program in FY 1986 between the Senate and House Small Business Committees. All the testimony, be it from representatives from the agencies, small business community or state officials, was highly supportive of the program, and is a matter of record.

Legislation

Congressman Mavroules, Chairman of the House Small Business Committee's Subcommittee on General Oversight and the Economy, introduced H.R. 4260, a bill to make the SBIR program permanent. This measure also provided that the Department of Defense could exclude from its base funds appropriated under category 6.6 (Operational Systems) for the purpose of calculating its SBIR budget.

After H.R. 4260 was favorably reported out of the House Small Business Committee, it was sequentially referred to six House Committees which held hearngs on the bill in July. Four of the six committees reported out H.R. 4260 favorably without an amendment. The Committee on Science and Technology also voted to make the program permanent, but amended the bill by requiring the Comptroller General to issue a report on the results of the SBIR program to Congress in 1995. The Committee on Energy and Commerce, however, amended the measure by only extending the SBIR program five years. A compromise was subsequently reached by the aforementioned committees in conjunction with the Small Business Committee to support the five-year extension, the DOD exclusion and the issuance of two Comptroller General reports by December 1993 and 1995 in exchange for the bill being placed on the suspension calendar prior to the Labor Day recess. H.R. 4260 passed the House of Representatives by a vote of 421–1 on August 13th.

While Members of the Senate Small Business Committee were opposed to the DOD exclusion, they believed the five-year extension outweighed the need to delay Senate consideration of the measure before the adjournment of the 99th Congress. The Committee adopted the House-passed version of the bill which was passed by a vote of 98–0 on September 17th. On October 6th, President Reagan signed H.R. 4260 into Public Law 99–443.

Members of the Committee are quite pleased with the development of the SBIR program to date. The record is clear that the initial results of the program have surpassed everyone's expectations,

enhancing and not jeopardizing the research missions of the individual agencies. While there were suggestions made at the oversight hearings by the small business community to improve the efficiency of the program, Members believe that it is premature to introduce any legislative initiatives which would sustantially change the current program. The SBIR program has provided a unique opportunity for the Federal government to tap the creative and entrepreneurial spirit of small businesses that makes this nation great.

Chapter VI. Entrepreneurship

Entrepreneurism—the desire to create new and independent businesses—is an important national spirit. Through entrepreneurship, new innovations and services are introduced into the marketplace to improve consumer choice and build economic strength so that the nation can compete effectively in global markets.

There is, however, no measure of entrepreneurship that counts both the newly self-employed and new businesses with employees. Proxy measures in the form of data on new incorporations and new start-ups have been generally used as indicators of entrepreneurial activities in the United States.

According to the 1985 President's Report on Small Business, there were approximately 2.5 million new incorporations nationwide from October 1980 to November 1983, representing an increase of 5.9 percent. Corporate profits were up 25 percent during the same period of time.

During the same perod of time, there were about 400,000 new business starts representing á 11.2 percent increase. Sole proprietorship income was up by 33.8 percent in the country.

The formation of new businesses also creates employment opportunities. From November 1982 to October 1984, approximately 6.5 million new non-farm jobs were created in the United States. Small business-dominated industries were responsible for 11.4 percent of these jobs, while large business-dominated industries added jobs at a rate of 5.3 percent. Given the resurgence of entrepreneurship in this country, the Subcommittee conducted hearings to examine the nature of entrepreneurial activities and the role government could play in fostering the spirit of entrepreneurship.

Senator Kasten, Chairman of the Subcommittee on Entrepreneurship and Special Problems Facing Small Business, held three days of hearings on the "Entrepreneurial Spirit in America." Two days of hearings were held in the State of Wisconsin on February 11 and 13 and the final day on March 27, 1986, in Washington, D.C.

The first two days of hearings were held at academic institutions in Wisconsin. On February 11th, the Subcommittee convened at the University of Wisconsin-Stout in Menomonie, with the February 13th hearing taking place in the morning at Fox Valley Technical Institute in Appleton and the afternoon session at Mount Mary College in Milwaukee. Testifying at these hearings were officials from the Small Business Administration (SBA), educators and Wisconsin entrepreneurs. Members of the Subcommittee were particularly interested in assessing the role government could play in fostering entre-reneurial activities, how educational institutions

prepare students with the requisite skills to start their own businesses, how did entrepreneurs finance their ventures, what motivated them to start their own businesses, how have they become successful at their endeavors, and what problems have they encountered in operating a business.

Richard Durkin, Regional Administrator of SBA, set the stage for the hearing by highlighting a few of the financial programs which are administered by SBA and are available to prospective Wisconsin entrepreneurs:

> SBA has made some 500,000 business loans since 1953, worth about $40 billion. In the State of Wisconsin alone, SBA has approximately 9,000 business loans in our portfolio of nearly $1 billion. This financial assistance has enabled thousands of entrepreneurs to achieve business success that might have been impossible without our help.
>
> In the financial area, SBA recently instituted a loan pooling agreement with selected banks, one of which is the First Wisconsin National Bank of Milwaukee. Through these pooling agreements, investors are offered an opportunity to buy into a pool of SBA loans. These loans have the full faith and credit guarantee of the Federal Government. This arrangement makes more funds available for small business lending by private institutions and often at lower rates.
>
> Additionally, SBA licenses Small Business Investment Companies (SBICs) which make long-term loans and equity capital investments to small firms. The firms receiving the basic assistance are usually new and in emerging industries that cannot find capital elsewhere.
>
> The SBICs, have invested $5 billion in more than 60,000 small businesses, including some noteworthy successes—Apple Computer, Federal Express, Wang Laboratories, and People's Express, to name but a few.

A significant number of colleges and universities have introduced entrepreneurial-type courses into their curricula since 1973. There are approximately 253 schools (212 of business and 41 of engineering) located at 245 institutions that have entrepreneurship curricula. While many schools vary in the breadth of courses offered, approximately twenty schools offer entrepreneurship as a major.

Dr. Robert S. Swanson, Chancellor of the University of Wisconsin-Stout, testified that the University has a state-wide mission to offer a business curriculum which reflects the needs of Wisconsin in the service and manufacturing industries:

> Stout serves industry through a mechanism that we call a center. We have 12 or 15 of these centers on the campus. Our centers include The Center for Innovation and Development; The Center for Vocational, Technical and Adult Education; the Small Business Development Center (SBDC), with a technical testing mission; The Employer Assistance Center; The Safety and Loss Control Center; Industrial Design Center—and, incidentially, that group is in Italy at this time with an innovative design in a new bath-

> room for the disabled-projects with industry; Market Research Center; and the Vocational Development Center. Stout maintains a co-op program for its students with industry as well as internships in industry. We have a thriving incubator program which has been mentioned previously.

An entrepreneur is a person who can develop and market a new product or improved service which will be of benefit to society. Entrepreneurs are often characterized as being self-confident, persistent, resourceful, innovative and competitive individuals. Some studies have indicated that they are usually first-born children. They are adaptable to change, have a strong desire to determine his or her own destiny and are willing to risk their life-savings and careers just to manage their own businesses.

John F. Bergstrom, President and CEO of Bergstrom Enterprise, Inc., operates eight businesses which employ over 900 employees. Mr. Bergstrom reflected on the reason for starting his own business:

> I was in a position where I had a father that worked very hard, but always worked for someone else. He was always in a position where he was under the gun of his employer. And I had made a mental note that was very much ingrained in my mind that I wanted to be my own boss no matter what I did.

Regardless of a person's desire or the quality of the product or service he or she wishes to promote, capital formation and business expertise dictate how profitable a business will become. Recent studies have indicated that about 90 percent of small business failures in the first five years of operation are due to either undercapitalization or the lack of managerial or technical expertise, Michael J. Healy, President, Hibernia Brewing Limited, Eau Claire, Wisconsin, testified on the kind of assistance he received to start Hibernia Brewing:

> What I would like to talk about now is the critical outside help received to make this purchase and to help this 95-year-old tradition survive. I committed all of my assets to the purchase and revitalization of the Walter Brewing Co. But without the assistance of the Small Business Administration, my dream would not have come true. Even though all of my financing was fully collateralized, the specialty brewing industry is such a new one that no bank would have worked with me without the guarantees and pledges of the Small Business [sic] Association.
>
> Today, Hibernia Brewing is a revitalized and growing company. We provide a paycheck for 50 families and pay hundreds of thousands of dollars in taxes. All of this would not have been possible without the assistance of our Government in the form of the Small Business Administration, and the advice and assistance at the State level from members of the faculty at the University of Wisconsin, Eau Claire.

In 1962, Ron Simek, President of Tombstone Pizza Corp., Medford, Wisconsin, started making complimentary slices of pizza for patrons of the family tavern. Today, the company is the fourth largest pizza maker in the country. Mr. Simek shared with Members of the Subcommittee how he was able to secure venture capital for the initial operation of his frozen pizza business:

> We went out to borrow $4,000 or $4,500 for a truck, and the bankers all laughed at us and said frozen pizza was a passing fad, that Tombstone Pizza—especially with the name—would never go any place. We finally talked to the banker in Stetsonville. The reason he agreed to lend us the money was that he could see our total monthly receipts and deposits at the bank getting larger and larger because we were selling more and more pizzas on our sales route. Finally he decided to lend us some money. We had about $25,000 equity, or I should say we had $25,000 worth of house and the tavern, probably about $18,000 in debts against them, maybe $25,000 worth of assets.
>
> So he considered our personal property. My son Jeff is in the audience. We even listed Jeff's high chair and everything else we had in the house in case we went "belly up," and he seemed to have everything. So by the time we got out loans through and got our truck completely built, he decided that he could lend us some money using the real estate as collateral. He'd leave the personal property, the TV and the radio and everything else, alone.

Mr. Simek also elicited some laughter from the audience by informing Members of the Subcommittee how he was able to avoid overhead costs by converting the family's four room flat into a pizza room until financing was secured for a plant:

> The boys' bedroom we converted to a freezer, the girls' bedroom we converted to a cooler, the kitchen, of course, was a kitchen, and the living room was the assembly area. My wife came home from bowling one night and found we had moved two 20 foot freezers into the living room and we had moved out the sofa. She almost had hysterics. And I said, "We can't make any money on the sofa, we need more freezers."

Another highly successful family-owned business is The Marcus Corporation of Milwaukee, Wisconsin. The Company has grown from a single movie theater in 1935, during the height of the depression, to a network of 32 corporations and partnerships which employs over 9,000 people in 16 states. Stephen Marcus, President and Chief Operating Officer, gave his opinion as to what problems entrepreneurs face today:

> A major problem facing all businessmen today is the tendency of Government to keep changing the rules of the game every few years. Five years ago there was a recognized need for the creation of new incentives for investment after many years of policies which discouraged capital formation.

> While, admittedly, the changes of the early 1980's may have gone too far, it seems clear that current proposed changes will take us back to a very slow growth posture. The severe cutbacks in appreciation rules puts the United States greatly at risk of becoming a nation whose main capital assets are desks and chairs as opposed to new plants and ever higher technology. Further, our ability to compete in international markets will be severely restricted.

While there is no talisman for the making of a successful enterprise, one of the most common traits is the entrepreneur's ability to capitalize on a market niche. Mr. Healy also testified that his brewery's production has gone from an estimated 12,000 barrels per year to 36,000 barrels in less than 10 months. He attributed such growth to the decisions he made as to where Hibernia Brewing, Ltd. fit in the overall scheme of the brewing industry:

> I decided that the key to success for my facility was the pursuit of the niche marketing concept. My beers are aimed directly at the imported beer drinker, the only segment of the beer market in the country to have grown last year, at 18 percent, and the only segment of the beer market to have shown at least a 15 percent growth over the last 10 years. We can manufacture in this country the finest beers in terms of not only quality, but taste, color, et cetera. We do not have to purchase those products overseas.

The March 23rd hearing in Washington, D.C., featured young entrepreneurs. According to several of the business magazines and newspapers, today's entrepreneurs, unlike thost in the past, are teenagers, business students, and increasingly, women. In addition, about twenty business schools in the country have been teaching entrepreneurial studies as a major degree since 1973. A national organization has also been formed to serve as a network for entrepreneurially minded youth. Of particular interest to Members of the Subcommittee was understanding this trend and assessing what motivated these individuals to accept the challenge of operating their own businesses.

The first witness was Dr. John Kao, Assistant Professor at Harvard Business School. Harvard offers a major in entrepreneurial studies with nine full-time faculty members engaged in entrepreneurship research and teaching. Dr. Kao shared with the Subcommittee the list of courses offered in entrepreneurship:

> A variety of new courses have been developed, including "Entrepreneurial Management" examines the process of starting new ventures; including "Entrepreneur Finance" which examines issues of financing new ventures as a way of creating value for individual and society; "Entrepreneurship, Creativity and Organization which looks at the human and organizational issues of entrepreneurial ventures. We also have courses in real property management; an several options which provide students with practical, field-base experience. I think that it is important to note

> that the students engaged in entrepreneurship study come from our second year, the elective year, of the Harvard MBA curriculum.

Dr. Kao included in his testimony statistics on enrollment and alumni activities to illustrate why the University is committed to teaching entrepreneurial studies;

> The demographics of our students may also be of some interest to you. There are approximately 750 students in each class, and this year about 500 students were enrolled in entrepreneurship courses of one kind or another. In fact, enrollments were at a level of 1,400, suggesting that the average Harvard MBA was taking about two entrepreneurship courses. In addition, enrollments in field-based practicums numbered some 140.
>
> It is also interesting to note the data on what happens to our alumni. The typical impression is that our alumni go off, work for and climb ladders in large established Fortune 100 companies. The truth is actually the reverse.
>
> A large, and increasingly growing, percentage each year of our alumnae wind up self-employed, and about a third of HBS alumnae report that they work for companies with fewer than 100 people. So, the topic of entrepreneurship at HBS has, in a sense, been accented by these career paths.

The second witness was Verne Harnish, Director, Association of College Entrepreneurs (ACE), Wichita State University, Wichita, Kansas. ACE's mission is to enhance and promote opportunities for young people interested in entrepreneurial pursuits. Mr. Harnish provided a background sketch and an update of ACE's activities.

Another witness, Kim Merrit, President of Kim's Khocolate, Inc. in Cumberland, Maryland, is eighteen years of age, and started selling her chocolate, as a hobby, when whe was eleven. Kim has been featured in Playboy, Family Computing, Money, People and Ms. Magazines and *USA Today,* for the success she has experienced as a young entrepreneur. Kim, who had just received a $75,000 loan to build a factory for her business, was also in the process of working a deal with Apple Computers to develop a custom line of chocolate for the company. Kim testified before the Subcommittee as to some of the frustrations she experienced in starting her own business. In addition to the traditional problems faced by start-up businesses, Kim pointed out that her youth was a unique problem because she was not old enough to enter into contracts, incorporate her business or sign for a loan.

John Cicarelli, State Director, Massachusetts Small Business Development Center, School of Management, University of Massachusetts at Amherst and President, Association of Small Business Development Centers, testified on the role Small Business Development Centers (SBDCs), sponsored by SBA, play in assisting entrepreneurs:

> The SBDC program is a very unique partnership of what you are looking for today, I think. It is a partnership of government at all of its levels; Federal, state, local, the educational community, and the private sector, all uniting

to provide management and technical assistance counseling and education and training programs to small business.

In 1985, the SBDC program provided assistance nationwide to 65,000 small business owners. Through their training and workshops and conferences, they educated over 172,000 small business owners. Since its inception, we have reached almost 0.75 million small business owners in this country.

Another program designed to assist start-up companies is the "incubator", which reduces the obstacles to new business formation by lowering certain overhead and variable costs associated with new ventures. Through its SBDC program, SBA actively promotes the concept throughout the country. The agency also assists potential incubator sponsors in refining their financial and administrative plans as well as help locate financing from the private and public sectors.

Members of the Subcommittee on Entrepreneurship and Special Problems Facing Entrepreneurs were quite impressed with the success of all of the entrepreneurs. While the entrepreneurs ranged in age from 18 to 60, it was evident that they shared several qualities: the need to determine their own destinies, the willingness to work long hours to launch their respective businesses, persistence, creativity and the need to receive assistance, be it in the form of venture capital or managerial and technical expertise.

Chapter VII. Small Business Patent Reform Legislation

Another victory for small businesses, independent inventors and non-profit entities was the passage of H.R. 2434, the Patent Trademark Office (PTO) Authorization Bill, which included a provision making the small inventor subsidy a permanent part of the statute on patents, section 41 of Title 35, United States Code.

Senator Weicker, Chairman of the Small Business Committee and then Chairman of the Appropriations Subcommittee which oversees PTO and the Department of Commerce, was concerned that the Administration's proposal to recover 100 percent for patent user fees would have a strong chilling effect on small business innovators. For that reason he introduced S. 2326, which established a two-tiered fee schedule to allow small businesses, independent inventors and non-profit entities to pay 50 percent, rather than 100 percent, of the cost of patent user fees. Under the law small firms pay $400 in filing and issuance fees and $1200 in maintenance fees. The maintenance fees are paid 3½, 7½ and 11½ years into the life of the patent, representing costs to the patent holder of $200, $400 and $600, respectively. The fee schedule was incorporated into PTO's three-year authorization bill. Congress enacted the legislation to ensure costs associated with the acutal processing of patent applications would not preclude small businesses, independent inventors and non-profit organizations from applying for U.S. patents.

On August 22, 1981, the President signed the small inventor subsidy into law as part of PTO's three-year authorization bill, P.L. 97-247.

Although the small inventor subsidy expired on September 30, 1985, Congress reauthorized the fee schedule for the 1986 fiscal year. In lieu of relying on the vagaries of annual authorization bills, the Senate and House Judiciary Committees agreed to make the small inventor subsidy a permanent part of the statute on patents effective FY 1987. H.R. 2434, The Patent and Trademark Authorization Bill, specifically provided that patent user fees shall be reduced by 50 percent with respect to their application to any small business concern as defined under section 3 of the Small Business Act, and to any independent inventor or non-profit organization as defined in regulations issued by the Commissioner of Patents and Trademarks. The House passed H.R. 2434 by voice vote on October 2, 1986.

The full Senate adopted H.R. 2434 by voice vote October 18, 1986.

The President was presented H.R. 2434 on October 27, 1986, and on November 6, 1986, was signed into Public Law 99-607.

The record is clear that small firms and independent inventors are the most innovative sector of the business community. It is also clear that these entities cannot afford to pay the full costs of patent user fees without this subsidized fee schedule. The enactment of this legislation marks a great achievement for small businesses, independent inventors and non-profit organizations, and will make a vital contribution to the nation's technological base by encouraging these entities to apply for U.S. patents.

Chapter VIII. White House Conference on Small Business

During the 98th Congress Senators Weicker and Bumpers were joined by over half of their Senate colleagues in introducing S. 2487, the White House Conference on Small Business Act of 1984. This legislation which required the President to reconvene a national conference before September 1986, preceded by at least one state or regional conference, was identical to a bill introduced in the House of Representatives the following day, and was modeled after a successful conference held in 1979-80. The bill quickly cleared the Congress in April 1984.

On May 8, 1984, President Reagan signed into law a bill providing for the 1986 White House Conference on Small Business (P.L. 98-276). The objective of the Conference, as described in its legislation, was as follows:

> The purpose of the Conference shall be to increase public awareness of the essential contribution of small business; to examine the status of minorities and women as small business owners; to assist small business in carrying out its role as the nation's job creator; to assemble small businesses to develop such specific and comprehensive recommendations for executive and legislative action as may be appropriate for maintaining and encouraging the economic viability of small business and, thereby, the nation; and to review the status of recommendations adopted at the 1980 White House Conference on Small Business.

An earlier White House Conference on Small Business had been convened in January of 1980. The 1980 Conference passed eleven resolutions and formulated sixty recommendations for congressional and executive branch action. Since that Conference, nearly two-thirds of those recommendations have been favorably acted upon by Congress and the 1981 Administration.

Fifty-seven state meetings preceded the 1986 White House Conference. They were conducted in each state of the nation (with an additional meeting in California, Florida, Illinois, New York, and Texas), plus meetings in the District of Columbia and Puerto Rico. Approximately twenty thousand entrepreneurs joined in the state meetings and a total of 2,232 resolutions emerged from them.

A series of six regional meetings, scheduled between June 10 and 27, expanded on the earlier state meetings. These regional meetings provided for in-depth discussion of issues from the eleven issue areas identified at the state meetings. Beginning with regional meetings, each of the eleven so-called Issue Sessions was chaired by a Commissioner appointed by the White House Conference on Small Business Executive Director. The eleven issue areas were: Economic Policy, Education and Training, Finance, Future of an Agency for Small Business, Innovation, International Trade, Liability Insurance, Payroll Costs, Procurement, Regulation and Paperwork, Taxation.

The National Conference held in Washington, D.C., in August 1986 culminated the two-year long White House Conference. It convened with 1,823 delegates in attendance. More than four hundred recommendations, gathered from state and regional meetings, were debated by the delegates with the goal of producing a rank-ordered list of sixty final recommendations. In a series of twice-daily meetings covering the eleven issue areas, delegates voted to reduce the original set of agenda items to 371, 200, 100 and finally to the rank-ordered 60 recommendations that were reported out from the Conference. The final recommendations were presented to the President and Congress in ceremonies concluding the Conference.

Below is a list of the final recommendations by the 1986 White House Conference on Small Business.

1. Because the liability insurance crisis in the United States has not only become a life and death sentence to many small businesses, but also is changing adversely our way of life, we must pursue a four-pronged effort at reform: civil justice reform; uniform standards for product, professional, and commercial liability; regulation of the insurance and reinsurance industries; and viable affordable alternatives to liability coverage.

We, therefore, strongly urge the President, the Congress, and the state legislatures to implement the following action as a vitally important step in alleviating the problems of availability and affordability of liability insurance to small business in America:

a. Civil Justice Reform:

1. Return to a fault-based standard of liability.

2. Base causation findings on credible scientific and medical evidence and opinions.

3. Eliminate joint and several liability in cases where defendants have not acted in concert.

4. Limit non-economic damages (such as pain and suffering, mental anguish, or punitive damages) to a fair and reasonable maximum dollar amount, not to exceed $250,000 in any case.

5. Restrict punitive damage awards to cases of willful and malicious conduct. The amount awarded shall go to a governmental trust fund, not the plaintiff.

6. Limit attorney contingency fees to reasonable amounts, on a sliding scale.

7. Reduce awards in cases where a plaintiff can be compensated by certain collateral sources, to prevent windfall double recovery.

8. The prevailing party in a legal action should have a statutory right to recover costs and attorney fees from the non-prevailing party.

9. Impose a uniform, reasonable statute of limitations and repose in all tort actions, and hold defendants to the state-of-the-art in existence at the time a product was manufactured or a service was performed.

10. Provide for periodic instead of lump-sum payments for future medical care or lost income.

11. Encourage use of alternative dispute resolution mechanisms to resolve cases out of court.

b. Federal Standards for Product, Professional, and Commercial Liability: Establish a uniform standard of fault-based product, commercial, and professional liability which incorporates provisions cited in "Civil Justice Reform," above.

c. Availability and Affordability of Liability Insurance and Reinsurance:

1. Review McCarran-Ferguson Act of 1945 as it applies to state regulation of insurance and the industry's limited exemption from antitrust laws.

2. Promote the establishment of joint underwriting associations and assigned risk pools.

3. A minimum of 60 days notice should be required if an insurer decides not to renew a policy or to increase its unit premium by more than 25 percent. Mid-term cancellations should be prohibited and premiums should be based on experience ratings.

4. Promote tax-deductible self-insurance through risk pooling and other group arrangements, including the expansion of the Risk Retention Act of 1981.

5. Legislate a self-insurance system that would allow small businesses to pay premiums into a fund with pre-tax dollars. The fund could be used for no other purpose than the payment of claims, with the fund being regulated in the same manner as any other insurance company.

6. Require the insurance industry to make complete financial disclosures by lines of insurance, so that Congress, state legislatures, and state insurance commissioners may call on this information at any time.

d. Education: Realizing that the most effective long-term solution to the liability insurance problem is a knowledgeable citizenry, we urge an ongoing education program to develop an awareness that:

1. The litigious nature of the American public will profoundly affect our way of life as the cost of public and private facilities becomes unaffordable.

2. There is no such thing as a riskless society, so each of us must assume some responsibility for his/her own safety and the normal hazards of everyday living.

[*1,419 votes of 1,715 ballots cast*]

2. There should be no government mandated employee benefits, such as employer-paid health benefits, parental leave, disability leave, etc. Specific actions should include, but not be limited to, the following:

a. Congress should prohibit the states from mandating employer benefits.

b. Congress should reject parental and disability leave legislation, such as H.R. 4300 and S. 2278.

c. Congress should reject proposals to mandate medical coverage. Business supports creative efforts in the private sector to identify new and voluntary approaches to enable working parents to fulfill their job and family responsibilities.

[*1,360 votes*]

3. Government at all levels has failed to protect small businesses from damaging levels of unfair competition. At the federal, state, and local levels, therefore, laws, regulations, and policies should:

a. Prohibit unfair competition in which non-profit tax-exempt organizations use their tax-exempt status and other advantages in selling products and services also offered by small businesses.

b. Prohibit direct, government-created competition in which government organizations perform commercial services.

These goals should be achieved by, but not limited to, the following ways:

Non-profits: Tax-exempt entities should not be permitted to use their tax status or postal rates to compete with commercial providers of products and services. Non-profit organizations receiving government grants and contracts, including federally funded research-and-development centers, should be prohibited from using federal dollars to compete with products and services provided by the private sector. Non-profits engaging in commercial activities should be prohibited from doing so while enjoying exemption from government regulations such as antitrust laws, worker's compensation, and health and safety rules.

Governments: New laws at all levels, particularly at the federal level, should require strict government reliance on the private sector for performance of commercial-type functions. When cost comparisons are necessary to accomplish conversion to private sector performance, laws must include provision for fair and equal cost comparisons. Funds controlled by a government entity must not be used to establish or conduct a commercial activity on U.S. property. Government regulated utilities should be prohibited from using their government favored position to compete in markets already served by small businesses.

A Federal Private Enterprise Review Committee shall be established as a permanent advisory group to the Chief Counsel for Advocacy of the Small Business Administration and to the Director of the Office of Management and Budget for the purpose of reviewing

federal government and non-profit actions that compete with small business.

[*1,267 votes*]

4. Be it resolved that the White House Conference on Small Business urges the President and the Congress to give top priority promptly to deficit reduction and a balanced budget. The White House Conference on Small Business urges immediate action on a balanced budget and a comprehensive plan, mandated by law, to reduce the federal deficit and control expenditures through legislation by implementing the following:

a. The Congress should correct the constitutional defect in the Balanced Budget and Emergency Deficit Control Act (Gramm-Rudman-Hollings) and adhere to its deficit reduction targets until the budget is in balance.

b. Pass a balanced budget amendment to the Constitution.

c. The President shall be granted by the Congress a budgetary line-item veto. Should the President exercise the option of line-item veto, the veto could be overridden by a simple majority vote of both houses of Congress. A two-thirds vote by both houses of Congress will still be required to override the veto of an entire appropriation bill. If this cannot be accomplished by legislation, we support a constitutional amendment to create a Presidential line-item veto.

d. The federal government should be required to adopt rank-order budgeting to allow for analysis of the effectiveness of subdivisions within a department.

e. An inter-agency task force should be established by the President and the Congress to implement all recommendations of value from the Grace Commission Report. All recommendations that need changes in law shall be presented to a bipartisan congressional committee for whatever actions are deemed necessary.

f. Income derived from the sale of government-fixed assets must go to the reduction of debt and shall not be used to supplement operating income for budget expense purposes.

[*1,175 votes*]

5. The international trade crisis mandates the creation of a Cabinet-level department of international trade (similar to those of our major trading competitors), which will coordinate and focus on existing activities of federal agencies to accomplish the following:

a. Coordinate the dissemination of information regarding business opportunities, export financing, education and training, licensing, trade missions, market-drive data bases, SIC code updates, and other essential functions of international trade.

b. Represent small manufacturing, agricultural, service, and other businesses in national and international discussions and negotiations. Develop and execute fair, long-term policies regarding international trade.

c. The General Agreement on Tariffs and Trade (GATT) should be extended to include intellectual property rights, services, agriculture, aqua-culture, and agri-business products.

[*1,173 votes*]

6. The federal government should encourage the advancement of entrepreneurial education and the study of the free enterprise system by promoting an early awareness of the free enterprise system, beginning with primary education and continuing through

all levels of education. This would include the teaching of foreign languages and intercultural practices, thereby increasing our national awareness of global economies and their interaction, and encouraging a greater competitiveness by small business in international markets. This training should be taught by small business people or teachers with hands-on entrepreneurial experience and must include curriculum input from small business people.
[*1,161 votes*]

7. Congress should repeal the Davis-Bacon Act and the Service Contract Act in their entireties.
[*1,156 votes*]

8. Congress should reform the Social Security system by taking the following steps: a. Remove all non-retirement programs from the Social Security programs and pay for them from the general fund.

b. Bring all workers—government and private—under the Social Security system.

c. Freeze the employer FICA contribution wage base and tax rate at the 1986 rate.

d. Cap automatic indexing and COLAs on program benefits.

e. Fund the establishment of a broad-based Presidential commission to develop long-range alternatives to the present Social Security system, a system which places an undue and inequitable escalating financial burden on businesses and their employees. This Presidential commission must submit its complete report within 24 months. The Social Security system needs to become actuarially sound on a defined contribution basis and not rely on automatic and regular increases in the tax rates and wage base. The following things need to be done:

1. Reduce Social Security taxes for employers and employees with alternative qualified retirement plans.

2. Extend the eligibility age of Social Security retirement and lift payroll earning restrictions for senior citizens by increasing what they can earn without forfeiting Social Security benefits.

3. Create parity between self-employment tax and employer/employee Social Security contributions.

4. Consider the possibility of a long-term phaseout of the present system to be replaced with an optional, actuarially sound, privatized system of retirement and health benefits. The privatization of the present system is considered to be a very desirable goal by the delegates to the 1986 White House Conference on Small Business.

[*1,152 votes*]

9. Enact S. 2760 with the Kasten-Lugar-Kassebaum amendment to provide uniform fault defenses, and the Pressler amendment eliminating joint and several liability.
[*1,146 votes*]

10. Equal Access to Justice, Regulatory Flexibility, and Internal Revenue Service procedural reform:

The IRS shall be subject to all the standards of the Equal Access to Justice Act as originally provided by the U.S. Senate in H.R. 3838 (as passed on June 24, 1986). The Senate bill provided that the

burden of proof for substantial justification shall be borne by the agency.

Further, Congress shall enact legislation which shall include the IRS and all other agencies within the requirements of the Regulatory Flexibility Act of 1980. The action or inaction of all federal agencies shall be subject to judicial review, under the Regulatory Flexibility Act.

Further, Congress shall enact legislation which makes the IRS financially accountable for all costs incurred by taxpayers as a result of IRS errors.

The Equal Access to Justice Act shall be amended to define recoverable costs to include accounting, legal, and other professional fees plus administrative costs.

Before going to court, a small business shall have the option to submit to binding arbitration any matter pertaining to a dispute with any federal agency (including the IRS and the U.S. Postal Service).

[*1,137 votes*]

11. The Congress and the Administration, in cooperation with state governments and the private sector, should develop and implement new capital formation and retention vehicles for small business, and there should be tax incentives for investment in small business, such as the Small Business Investment Incentive Act (H.R. 1941). This would allow an opportunity for small business capital accumulation.

[*1,109 votes*]

12. A federal capital gains tax should be enacted which will provide savers and investors in an operating business with:

a. Deferral of tax on gain if proceeds are reinvested in a qualified operating business or an IRA account within 18 months.

b. A normal capital gains tax rate of 75 percent of the regular income tax rate for the gain if held for two years.

c. A special capital gains tax rate of 50 percent of the regular income tax rate if held for five years.

d. An entrepreneurial capital gains tax rate available only to a former or present founder or full-time manager-owner who has held the investment for at least 15 years with a step-rated favorable capital gains rate.

Any grain resulting from the sale or liquidation of a small business should qualify for tax treatment similar to a "lum-sum" distribution from a qualified retirement plan (i.e., ten-year average—five-year average proposed in H.R. 3838—or rollover to an IRA) or the tax on the gain may be deferred by reinvesting the proceeds of the gain in a qualified small business.

The benefits of Section 337 of the IRS code (otherwise known as the general utilities doctrine) should be retained. To explain, a corporation incurs a tax on the sale of its assets. Under the general utilities doctrine, the corporation avoids the tax on the sale or distribution of its assets to its owner in liquidation. A one-time tax is incurred by the owner upon the receipt of the corporation's property instead of a double tax at the corporate and individual levels.

[*1.075 votes*]

13. Resolved that the SBA should be maintained as an agency independent of any other federal department. The administrator

should be elevated to Cabinet level, and the SBA programs should be continued as presently constituted.
[*1.051 votes*]

14. The Senate and the President should join the House of Representatives in reauthorizing the Small Business Innovation Research (SBIR) program by enacting H.R. 4260 before the present Congress adjourns. The next Congress should strengthen the program still further by:

a. Increasing each agency's share of research-and-development expenditures devoted to it by 0.25 percent per year, until it is 3 percent of the total extramural research-and-development funds.

b. Making the program permanent with a formal review every ten years, beginning in 1993.

c. Allocating a modest but appropriate share of each agency's SBIR fund for administrative purposes for effective management, quality maintenance, and the elimination of program delays.

d. Determining annually that each agency is clearly in full compliance with the law and that SBIR program funding is not being accompanied by parallel reductions in other small business programs.

e. Creating pooled solicitations once or twice a year of subjects submitted by small agencies expending $20 million to $100 million in extramural research-and-development funds, to facilitate their involvement in the SBIR program.
[*1,043 votes*]

15. Protection of intellectual property in the form of patents, trademarks, copyrights, technical data, and deliverables is critical to the growth of small business. The federal government and its contractors should be required to honor confidentiality for protecting domestic intellectual property nationally and internationally. To this end, modifications and additions to existing systems are necessary, including:

a. Implement a system by which a U.S. small business may elect an accelerated short-term patent-filing and approval procedure by simple registration.

b. Make the tiered fee schedule within the Patent Office more equitable by charging fees for information and services as well as for filing and maintenance, and by setting fees which are lower for first filings of national patents than filings by foreign applicants.

c. Establish an accelerated judicial procedure within the district courts which utilizes patent and trademark expertise and thereby expedites litigation concerning patent and trademark infringement.

d. The President and Congress should work toward the establishment of coordinated filings in the Western Hemisphere and Pacific Rim countries.

e. Develop a set of verifiable and enforceable copyright procedures to strengthen enforcement of U.S. copyrights, in both domestic and international markets, through the joint efforts of the Copyright Office and the private sector, including representation by small business.

f. Laws and regulations regarding proprietary rights in technology and "rights in data" on government contracts shall be changed to allow small business to maintain its proprietary rights.

g. The Freedom of Information Act should be amended to shift the burden to the requestor for obtaining release of proprietary and confidential information.

h. Congress shall collect data and analyze new technologies being developed to assist it in enacting appropriate legislation for the expansion of the intellectual property law system adequately to cover these new technologies.

i. Establish a management oversight group, to include small business people, which would ensure efficient and effective implementation of the intent of the Patent Office mandate to be a national resource.

[*1,034 votes*]

16. The Investment Tax Credit should be retained, or restored for new and used equipment for small business (i.e., those businesses with fewer than 500 employees) and should be limited to end users of the property purchased. The tax credit should provide added incentive to domestically produced products.

[*972 votes*]

17. The federal government, industry, school administrations, and businesses should work together to solve the drug problem in our society by fighting international drug dealers and organized crime. The war on drugs should be fought in at least four areas:

a. By cutting the growth and production of illegal drugs abroad and in the U.S.

b. By educating Americans to say NO to drugs and to rehabilitate chemically-dependent people.

c. By stopping illegal drugs from entering our borders and U.S. dollars from leaving.

d. By working to have a "drug free" school system and "drug free" work force in American business and industry.

d. By working to have a "drug free" school system and "drug free" work force in American business and industry.

[*964 votes*]

18. The federal government should increase its awards to small businesses to 35 percent of total contract dollars by FY 1990 and bring the percentage in line with small business' contribution to the Gross National Product by FY 1993. This shall be achieved through actions that:

a. Create a congressionally-appointed blue ribbon commission to review and recommend changes in public policy, incentives, and regulations; to reshape procurement practices to achieve full participation by small business; and to recommend model programs for small businesses to be tested by the Office of Federal Procurement Policy. Further, the majority of the members of the commission are to be small business owners and the commission will establish an advisory panel to monitor and report on the implementation of the commission report.

b. Distribute set-asides by each procurement agency evenly across all categories of goods and services for small businesses, with significant percentages to minorities and women.

c. Simplify the procurement process and expedite the award process.

d. Require that all agencies annually publish a two-year procurement plan that identifies known potential procurements and designates those to be set aside.

e. Mandate accountability and provide incentives for government procurement officials and prime contractors to increase their use of small businesses, including women and minorities.

f. Retain the existing "Rule of Two" and enforce it strongly as a standard for small business set-asides.

g. Develop a standard approach for setting size standards by SIC codes based on sound economic data to ensure that size standards are equitable, rational, and consistent. Further, the government should develop procurement procedures that ease "graduation shock" for companies transitioning out of their small business size standards.

h. P.L. 95–507 and Executive Order 12138 should be strictly enforced, and mandatory incentives and penalties should be established for compliance and noncompliance therewith.

[*948 votes*]

19. That Congress enact H.R. 1575 and/or S. 1486 to ensure equal access to commercial credit for all small businesses and to ensure that women and minorities are not discriminated against in granting commercial credit by eliminating the business credit exemption to the Equal Credit Opportunity Act.

[*931 votes*]

20. To promote the retirement security of our nation's employees, Congress must support and promote the continued viability of the private retirement system in the small business community. In support of this goal, there must be a five-year moratorium on further changes in our private retirement plan laws except for the following changes which we recommend:

a. Promote parity between large and small plans and between private and public sector plans.

b. Simplify filing requirements and paperwork.

c. Increase contribution benefit limits, including 401(k) plans and IRAs, to be at least as great as the pre-1986 Tax Reform Act limits.

d. In the multi-employer sector, reform Multi-Employer Pension laws (Multi-Employer Pension Plan Amendments Act of 1980, MPPAA, subtitle E of Title IV of ERISA, sections 4201 through 4402) to curtail or eliminate withdrawal liability.

[*861 votes*]

21. Eliminate governmental disincentives directed against home-based business owners. Specifically, Congress should:

a. Pass Senator Hatch's Freedom of Workplace Act.

b. Instruct the U.S. Secretary of Labor, by resolution, to repeal 29 Code of Federal Regulations 530.

c. Instruct the IRS to remove the home-based business red flag from IRS Form 1040 Schedule C.

[*581 votes*]

22. We recommend that the present law regarding cash basis method of accounting for tax purposes should be retained for all small businesses. The current tax code should not be changed regarding:

a. Use of a fiscal year.

b. Completed contract method of accounting.

[*827 votes*]

23. The current surtax exemption for corporations should be expanded to $200,000 per year, with a proportionate rate of tax as applied under current law to each expanded level thereunder, *and* a similar lower individual tax rate should be applied to business income derived from sole proprietorships, subchapter S corporations, and partnerships not engaged in passive income pursuits. These surtax exemption levels should be indexed to inflation.

The direct expensing provision should be increased to $150,000 to help small businesses retain capital for expansion. Also, inventories for small business should not include a requirement to capitalize wages, rents, or other overhead items.

[*788 votes*]

24. Congress should eliminate estate and gift transfer taxes on the transfer of small business assets to a family member. A family member is defined in 26 U.S.C. 2032A, and the entity should qualify as a small business.

[*774 votes*]

25. Be it resolved that a commission be established to study the impact of services, information, and emerging technology sectors of the American economy; review existing Standard Industrial Classification (SIC) codes to ensure that they reflect the current state of the respective industries; and make recommendations with regard to appropriate federal legislation and regulations that will promote further growth in this area and ensure proper classifications for all industries.

Be is further resolved that Congress shall enact legislation directing the Executive Branch to create, as a successor to the SIC codes, a new data collection and dissemination system that will:

a. Evolve with the continuing growth of the American economy.

b. Allow for crosswalking among all major federal data systems—including but not limited to SIC codes, government procurement systems, contract tracking, management information systems, and internationally traded goods and services—incorporating where possible all relevant international data systems.

c. Identify the amount of commercial economic activity performed in the not-for-profit, franchise, and similar sectors.

d. Be updated as to data collection methodologies on a regularly scheduled basis.

e. Provide to the entire business community, through a specified governmental source, appropriate and timely access to individual and aggregate information.

[*766 votes*]

26. Congress should not tax employee benefits above existing levels.

[*720 votes*]

27. Enact into federal law Small Business Participating Debentures (SBPDs) as encompassed by S.B. 1498, which would permit the issuance of SBPDs, providing for a fixed rate of interest plus a participation redeemable at a predetermined price on a future date and involving no ownership interest. the participating share of earnings would be taxed to the investor as a long-term capital gain, but deductible by the issuing company. Losses would be allowd as an ordinary deduction for the investor. SBPDs would combine the

benefits of equity and debt financing, which would make private investment in small business more desirable.
[*696 votes*]

28. "A Bigger Slice of the Pie". Ensure that small business receives a larger and more equitable share of federal procurement funds;

Increase the opportunities for all small businesses to participate in federal procurement on a streamlined and equitable basis;

Promote cooperation and mutual support within the small business community as a whole; and

Preserve the opportunities and protection currently provided for targeted minority groups.

Require that:

a. Not less than 40 percent of all government procurement monies be awarded to small businesses by each department and agency of the government. This should include not less than 40 percent of prime contract funds and not less than 40 percent of the subcontract funds provided by large business prime contractors via subcontracts, including but not limited to the Surface Transportation Act.

b. Not less than 10 percent of all government procurement monies be awarded to currently targeted minority groups.

c. Not less than 5 percent of all government procurement monies be awarded to women-owned businesses.

d. Not less than 25 percent of all government procurement monies be awarded to other small businesses, including those owned by veterans and physically challenged individuals.

e. Small business procurement be simplified and awards be made not later than 30 days after receipt of proposals.

f. OMB Circular A-76 be made to apply to all federal monies used directly or indirectly in provision of goods and services which are available in the private sector.

g. Congress should maintain and enforce the minority and women-owned business set-aside programs under the Surface Transportation Assistance Act of 1982 (P.L. 97-424), P.L. 95-507, and 8(a) program.

h. Distribute set-asides by each procurement agency evenly across all categories of goods and services for small businesses.

i. Of the total dollars spent by the federal government with small business collectively:

1. 25 percent will be targeted to minorities.
2. 12.5 percent will be targeted to women.
3. The balance of the total monies, 62.5 percent, will be targeted to all small businesses.

[*683 votes*]

29. Congress should implement the recommendations of the Grace Commission, with priority attention to:

a. The 15-bill Grace Commission legislative package for 1986 (introduced by the House and Senate Grace Commission caucuses in June of 1986) which has a combined cost-savings potential of $32.8 billion over three years (S. 2620/H.R. 5125; S. 2619/H.R. 5129; S. 2621/H.R. 5116; S. 2628/H.R. 5117; S. 2624/H.R. 5113; S. 2629/H.R. 5106; S. 2623/H.R. 5099; S. 2625/H.R. 5130; S. 2630/H.R. 5114; S.

2633; S. 2631/H.R. 5128; S. 2622/H.R. 5105; S. 2626/H.R. 5115; S. 2632/H.R. 5100; and S. 2627 H.R. 5157).

b. Privatization of public services through the contracting out of sale of service and commercial operations to the private sector.

c. Sale of excess (non-wilderness) federal lands.

d. Congress should act on all remaining Grace Commission recommendations by December 1988.

[*673 votes*]

30. In order for American business to compete in foreign countries with other nations, we need to clarify the Foreign Corrupt Practices Act. Congress should pass legislation similar to language in S. 1860, Title IX, Subtitle B:

a. The name of the act will be the Business Practices and Records Act.

b. Willful bribes to any foreign officials will remain prohibited.

c. United States companies will be liable if they pay a bribe directly or if they "expressly or by a course of conduct" direct or authorize a bribe.

d. All exceptions will be codified, including those that are explicitly stated as well as those which have been permitted under the present law.

e. Payments made "for the purpose of expediting or securing the performance of a routine governmental action" will not be unlawful.

f. Payments which are expressly permitted by law, custom, or regulations of a foreign country will not be unlawful.

[*666 votes*]

31. Unemployment Insurance: Amend the Federal Unemployment Tax Act, the Social Security Act, and the Wagner-Peyser Act to achieve the following:

a. Prohibit strikers from collecting benefits.

b. Require claimants to actively seek work and accept the next best job after eight weeks of job search or lose benefits.

c. Eliminate FUTA and related taxes on wages of persons who do not qualify for benefits (e.g., independent contractors, corporate officers, shareholders, retirees, etc.).

d. Allow surplus funds to be invested in the state which paid the taxes.

e. Cap FUTA tax at present levels.

f. The rate increase of .2 percent in FUTA taxes should be allowed to expire on January 1, 1988, as scheduled under current law.

[*654 votes*]

32. Prompt pay legislation should: be extended to cover the Postal Service and federally assisted procurement; be strengthened through an amendment to the 1982 Prompt Payment Act to eliminate the 15-day grace period; require automatic payment of interest penalties; more clearly define that the entire payment process, including acceptance, must occur within 30 days; include progress payments and retainage; and require prime contractors to pay their subcontractors within seven days after receiving payment from the government or incur interest payment penalties. In addition, when the government pays the prime contractors late, interest payments shall flow through from prime contractors to subcon-

tractors on a pro-rata basis. The Prompt Payment Act shall be vigorously enforced by all branches of government.
[*652 votes*]

33. Congress should institute a broad-based incentive program that would encourage the training and retraining of current and new employees by small business owners, thereby furthering new employment opportunities.
[*628 votes*]

34. A program should be developed in partnership with business and government on the state and federal levels for education in the free enterprise system. The program would include:

a. Development of curricula on the roll of small business in free enterprise.

b. Vocational training, with special emphasis on dropouts.

c. Pilot business training programs at the secondary level.

d. Professional training, management assistance, and internship programs for existing businesses.

e. Coordination and combination of existing federal job training programs by the federal government.

f. A national conference for the development of this idea and further conferences as necessary for ongoing development and review of the program.

Grants and incentives would be made available to small businesses to enable them to participate in the entire program. Courses would be taught using state-of-the-art technology by qualifed teachers with demonstrated hands-on business experience and using known management efficiency practices.
[*614 votes*]

35. "Export SBIR". Increase exports by small business by:

a. Creation of an annual, competitive small business export incentive program similar to the highly successful SBIR [1] program, to be funded within existing international trade progams.

b. Retention and improvement of the current Small Business Foreign Sales Corporation tax incentives further to encourage exports of products and services.

c. Aggressive marketing of small business export trade programs using private sector organizations or businesses.
[*600 votes*]

36. Transitional rules for tax legislation should be implemented and applied equally for all taxpayers. Legislation should not be retroactive if it would adversely affect prior transactions.
[*597 votes*]

37. Bankruptcy laws are too lenient! Federal bankruptcy laws should be modified with regard to:

a. Restructuring the preferred payment rules.

b. Placing strict controls on the financial dealings of Chapter 11 "debtor-in-possession" cases.

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[1] The Small Business Innovation Research approach is a competitive annual program which solicits small business proposals to solve problems instead of responding to government solutions. It offers a significant multiplier effect, requires no new government funding, and requires a commitment of private sector funds.

c. Creating a review procedure for trustees to assure that creditors obtain timely financial reports of the bankruptcy operational reports, and to avoid self-dealing and patronage.

d. Providing equitable reimbursement to creditors from future earnings of debtor.

e. Limiting lawyers' participation to same as other creditors.

f. Establishing a bankruptcy ombudsman to make sure that small business creditors are treated fairly.

g. Providing either a first priority lien to an unpaid seller of a product or a right to recover the product.

[*584 votes*]

38. To reduce payroll complexity and cost by:

a. Standardizing federal payroll reporting on one form with one due date and providing incentives to include consolidation of state and local payroll information [see Appendix 5 for sample form].

b. Increasing the threshold for requiring payment of payroll taxes through federal depositories (i.e., allow mailing in of larger payments with quarterly filing; currently, the threshold is $500) and increasing the thresholds for determining the frequency of all payroll tax deposits (i.e., increase threshold for three-day deposits, which is currently $3,000).

[*576 votes*]

39. Adopt a basic economic policy that will continue to improve our economic climate by removing obstacles to our free enterprise system and allowing it to function with minimum government restraints. This national economic policy should be instituted to phase out all government pricing, production, and export controls currently imposed on U.S. business. It should include deregulation of the energy industry by decontrolling natural gas, removing the foreign policy-based controls on the export of natural resources and oil field service equipment, and by reducing bureaucratic barriers to U.S. petroleum exploration and production efforts. And, finally, deregulate the steel industry.

[*560 votes*]

40. The nation's farm policies should be changed to facilitate a phaseout of price supports and governmental production controls within an established time frame, thereby returning agriculture to a market orientation, while bringing all pressures to bear in the General Agreement on Tariffs and Trade (GATT) deliberations to ensure that other importing and exporting nations adhere to policies which promote free and fair trade in agricultural commodities.

[*557 votes*]

41. Congress should pass legislation for a self-insurance system that would allow small businesses to pay premiums into a fund with pre-tax dollars, which could not be used for any other purpose except to pay claims, with the fund being regulated in the same manner as any other insurance company. Approve the Risk Retention Act of 1981, as passed by the Senate and now before the House as H.R. 5225, at this date without further amendment.

[*543 votes*]

42. Federal or state legislative bodies shall encourage, authorize, and approve the creative use of semi-public loan or guarantee corporations to meet the needs of small firms. This capital can be used for start-up, venture capital, business expansion, capital improve-

ment, fixed asset financing, and/or intangible collateral financing. These vehicles should be many or multi-faceted. They should also be self-funded, revenue-neutral. The legislation would create a loan guarantee vehicle similar to Fannie Mae (FNMA) to meet the needs of small business.

The express purpose of such vehicles would be to create secondary markets that encourage public and private investors. These loans would start at $10,000 and would require each participating lender to take a certain portfolio percentage of the smaller loans. The program would provide access to credit, not underwrite the costs thereof.

[*533 votes*]

43. It is recommended that the "Rule of Two" be retained and strongly enforced as a standard for small business set-asides. This regulation prescribes the circumstances under which a contracting officer makes the determination to restrict a contracting opportunity to exclusive competition among eligible small business concerns. The contracting officer must set aside a contracting opportunity if there is a reasonable expectation of receiving offers from at least two eligible small business concerns capable of meeting the government's requirements at reasonable prices.

[*531 votes*]

44. The Congress must pass legislation creating a uniform national product and general liability law which bases liability on fault (no liability without responsibility) and which totally eliminates joint and several liability (no more deep-pocket liability).

[*487 votes*]

45. The SBA should be retained and elevated to a Cabinet-level position whose mission should be to assist the small business community, with the private sector having a stronger partnership role.

To ensure that SBA's mission remains focused on areas of greatest need:

a. The independent role of the Office of Advocacy must be maintained and strengthened.

b. The Congress should mandate a comprehensive review of all SBA programs to assess their efficiency and their appropriateness to the broad needs of the small business community. That review should be conducted with substantial input from the private sector, with the leadership of the small business constituency.

c. In the delivery of lending and management assistance services, SBA should be directed to increase its reliance on local resources in the private business sector which have expertise in its program areas.

[*484 votes*]

46. The presence of a de facto common language in the U.S. has permitted unprecedented growth and stability in our history as a 210-year-old democracy. Now, recent changes in legislative and administrative law have had the effect of promoting bilingualism, which slows the assimilation process for immigrants (to their disadvantage) and threatens to add permanent social and economic costs to our society in general and to business in particular. These costs will fall disproportionately on small business.

English should be declared as the official language of the U.S., legally sufficient for all legislation and communication in this

country. The federal government should print its publications, posters, signs, and forms in English only. English usage should be encouraged through the phasing out of most bilingual programs; funds appropriated for most bilingual programs instead should be used to promote Engish as a second language. Certain exceptions regarding diplomacy, international needs, demands of justice, and safety signs at airports and highways should apply.

At the federal level, this should be done through congressional action, Presidential order, and also through the Department of Education.

[*467 votes*]

47. Presidential line-item veto authority should be passed by Congress.

[*453 votes*]

48. Professional and technical services constitute a dynamic and fast-emerging sector of the services industry. The current acquisition system was originally designed to procure hardware, and has not been effectively adapted to the challenging task of procuring sophisticated, unique professional and technical services. Moreover, federal government personnel do not understand or appreciate the waste and problems created by policies of procuring sophisticated services on the basis of lowest cost rather than quality. In cases where the government does advertise the fact that high technical quality is more important than cost or price, the procurement selection process—by engaging in technical leveling and auctioning—frustrates the offer of high quality. A new, simplified acqusition system is required for contractors to continue to be motivated to offer high-quality services and to ensure the long-term benefits of high quality to the federal government. Therefore, be it resolved that:

a. The Government Accounting Office (GAO) should conduct a study of professional and technical services. GAO should examine agency conduct with respect to cost and quality tradeoffs in professional and technical services contracts, and frequency of prohibited practices such as technical leveling and cost auctioning. GAO should report the results to Congress and the Office of Federal Procurement Policy (OFPP).

b. OFPP should develop and implement on a demonstration basis a simplified alternative acquisition process adapted to the procurement of professional and technical services—a process which would ensure to the government the benefits of competitively procured professional and technical services, and increase access to the procurement system for businesses of all size, including small businesses.

c. Congress and OFPP should require technical training for federal program and contracting personnel concerning the acquisition of professional and technical services, to assure that high-quality services are obtained in cases where quality is more important than cost.

d. Congress and OFPP should preclude federal agencies from establishing new federally funded research-and-development centers (now receiving more than $5 billion in sole source contracts per year) unless the agency has conclusively demonstrated that the private sector does not have the necessary capabilities. Further, Con-

gress and OFPP should limit contracting with existing federally funded research-and-development centers through oversight, preclude them from obtaining contracts outside their original charters, and sunset where appropriate.
[*437 votes*]

49. Authorize the formation of Small Business Reinvestment Corporation (SBRCs) to obtain capital from private and public pension plans and invest that capital in small business. Federal enabling legislation will provide that such investments comply with the "prudent man" rule for pension plan trustees.
[*435 votes*]

50. A White House Conference on Small Business should be scheduled for 1990—while Congress is in session—with subsequent conferences every four years thereafter.
[*431 votes*]

51. There should be small business advocates on all appropriate national policy boards, including the Council of Economic Advisors. Office of Management and Budget, Treasury Department, and the Federal Trade Commission. Further, each of the 12 Reserve Banks that make up the Federal Reserve System and the Federal Reserve Board shall permanently set aside at least one appointment for a currently active small business person. This process would be monitored through local, state, and national business organizations.
[*430 votes*]

52. Be it resolved that:

a. The 8(a) program should be maintained under the SBA rather than being transferred to the Department of Commerce, because of SBA's demonstrated sensitivity to the needs of small and disadvantaged businesses.

b. The 8(a) application procedures should be streamlined by eliminating unnecessary duplication at the district, regional, and national levels, so as to expand the number of socially and economically disadvantaged firms participating in the program.

c. Subcontracting with small businesses should be promoted by creating positive incentives that reward prime contractors for effectively utilizing small and disadvantaged firms, and penalizing noncompliance with Section 8(d) of P.L. 95-507.

d. The SBA should sponsor and promote programs within the private sector that assist small and disadvantaged businesses in learning competitive skills and in developing private sector markets.

e. The SBA and the Office of Federal Procurement Policy should provide for sensitivity training and technical training for federal program and contracting personnel to assure that they understand the goals and objectives of the small business set-aside and the 8(a) programs, and the enormous value these programs bring to federal procurement and the American economy.

f. In preparation for graduation from the 8(a) program, the SBA should establish a transition process for small and disadvantaged businesses that rewards excellence, high performance, and growth—rather than severely penalzing the very growth, job creation, and success which federal policy should encourage, but does not.
[*413 votes*]

53. The concept of comparable worth is contrary to the free enterprise system. Compensation should be based upon market supply and demand.
[*408 votes*]

54. Congress should enact labor law reform to repeal the union shop provision of Section 8(a)3 of the Labor Management Relations Act, as amended, to allow employees the fullest freedom of choice to join or not join or support a union, and amend the Hobbs Act to make violence in labor disputes a federal crime.
[*395 votes*]

55. The existing guaranteed loan programs should be maintained with the maximum limits being raised to $1 million. The programs should be expanded to allow working capital and revolving credit line loans and to encourage smaller loans (e.g., $10,000–$20,000).
[*390 votes*]

56. Congress should defeat proposed anti-double breasting legislation (H.R. 281 and S. 2181).
[*378 votes*]

57. "A Penny Earned Is a Small Business Saved". Create a state-administered pool of money from public and private business debt offerings, interstate, to help small business through loan guarantees. This guarantee pool would be funded by an additional one penny for every ten dollars of debt offering (or one-tenth of 1 percent) registered or filed with the Securities and Exchange Commission. Each state and the District of Columbia will be allocated a portion of the guarantee pool based on population, with no less than $500,000 to any one state, and each state will administer and control its portion of the pool through a commission of private citizens appointed by the governor. Each state can use the guarantee pool to support its business goals and economic agenda.
[*377 votes*]

58. The Industrial Revenue Bond program should be maintained with emphasis on serving those small businesses with employees less than 500 and/or sales less than $20 million, with the continued provision for the deductibility of 85 percent of the interest by banks holding such bonds and 100 percent tax-exempt status when-held by any non-bank holder.
[*367 votes*]

59. Whereas, the antitrust laws of the United States have been the strong underpinning of the American free enterprise system through ensuring a free and open marketplace;

Whereas, the antitrust laws of the United States are the first line of defense against anticompetitive activity, are critical to the health of the economy, and are vital to the survival of small businesses in America;

Whereas, on February 19, 1986, the Reagan Admininstration announced five legislative proposals to amend the antitrust laws of the United States which would seriously weaken America's antitrust laws and encourage monopoly, mergers, acquisitions, vertical price fixing, and other forms of anticompetitive behavior plus reduce the incentive of injured private citizens and companies to bring civil suit against the perpetrators of antitrust violations for injuries suffered;

Now, therefore, be it resolved by the White House Conference on Small Business as follows:

First, that the Congress is urged to reject the Administration's proposed antitrust law legislative package as inimical to the free enterprise system and a direct threat to the ability of small business to compete against monopolies, conglomerates, trusts, and combines.

Second, that the Federal Trade Commission and the Antitrust Division of the Department of Justice are urged to enforce vigorously the antitrust laws of the United States in the following areas where enforcement is now lacking:

a. Anticompetitive mergers and acquisitions.

b. Resale price maintenance.

c. Tying arrangements.

d. Unreasonable territorial and customer restrictions.

Third, Senator Rudman and the other members of the Senate Committee on Small Business are to be commended for their opposition to the "Vertical Restraints Guidelines" published by the Department of Justice of January 23, 1985-which do not accurately state current antitrust law-and for urging that the Vertical Restraints Guidelines be withdrawn as per Senate Concurrent Resolution 56.

[*247 votes*]

60. Strengthen and expand the Small Business Development Center (SBDC) program to provide greater outreach. Maintain the SBDC autonomy and strengthen its ties to the academic community.

[*319 votes*]

On June 23, 1986 Senator Pete Domenici along with 20 cosponsors introduced legislation to provide for a White House Conference on Small Business once during each Presidential term. The Committee did not act on this proposal pending the outcome of the August conference. Senator Domenici, however, indicated that he would re-introduce the bill in the 100th Congress.

Chapter IX. Small Business and Government Procurement

The Federal Procurement Market

The Federal Government's needs for a vast array of supplies, services, and construction has always represented an important market to many small business firms. The Committee on Small Business has consistently expended substantial effort in both oversight and legislative activities to eliminate obstacles to small business participation in the Federal procurement market and to encourage affirmative steps to see that small firms receive their "fair share" of federal contracts in conformity with the national policy enunciated in the Small Business Act.

The Federal procurement market is truly vast and diversified. During Fiscal Year 1985, Federal agencies made slightly more than 23 million separate procurement actions, totaling $180 billion. Of this amount, small business won approximately $33 billion or 18.4 percent of the total dollars awarded. Slightly more than 51 percent of these contract dollars were won in open competition against all

competitors. The other 48.6 percent were won in competition restricted to other eligible small business concerns, so-called small business set-aside procurements conducted by the various agencies under the authority of Section 15 of the Small Business Act.

Like the Small Business Act, the Committee has also given special attention to procurement opportunities for small business concerns owned and controlled by socially and economically disadvantaged individuals. During Fiscal Year 1985, for example, such firms won approximately $1.1 billion in Defense contracts awards in open competition or in small business set-aside competitions. Small business concerns owned and controlled by socially and economically disadvantaged individuals were awarded an additional, $1.8 billion under the preferential procurement program authorized by Section 8(a) of the Small Business Act. Under the so called 8(a) program, the Small Business Administration (SBA) identifies a contracting opportunity that it believes meets the business development plan of a certified 8(a) program participant and seeks to have that contracting opportunity set-aside. The agency with the procurement opportunity then enters into a contract with SBA, which, in turn, then subcontracts with the 8(a) firm. The negotiated terms and conditions of the contract between the SBA and the agency with the procurement opportunity must reflect the mission needs of the requiring agency; the contract price and hence the subcontract price, must be found to reflect "fair market value" for supplies being provided or the services being rendered.

During the 99th Congress, the Commission undertook an array of oversight activities to foster small and small disadvantaged business participants in the Federal procurement market.

Expanding Small Business Participation

Attaining Full Implementation of the SBA Breakout Procurement Center Representative Program and Initiation of a Pilot SBA System Procurement Center Representative Program.

During the 99th Congress, the Committee on Small Business worked in close cooperation with the Subcommittee on Commerce, Justice, the Judiciary, and Related Agencies of the Committee on Approprations to foster full implementation of the SBA Breakout Procurement Center Representative (BPCR) Program and to urge SBA initiation of a Pilot Systems Procurement Center Representative (SPCR) Program. The Appropriations Acts for SBA for Fiscal Years 1986 and 1987, Public Laws 99–180 and 99–500 respectively, both contained provisions relating to these two SBA programs designed to assist small firms to participate in the Federal procurement market as prime contractors or subcontractors.

The SBA BPCR Program was initiated as a Pilot Program in 1979. BPCRs were placed at four of the Air Logistics Centers (ALCs) of the Air Force Logistics Command. Their primary function was to identify and overcome the obstacles preventing a competitive procurement and to encourage small business concerns to participate in future competitive procurements for the items so "broken-out." The program has had impressive results. During the first eighteen months, the General Accounting Office found that the four pilot BPCRs has been able to save slightly over $7.3 mil-

lion through the breakout of 294 items. In FY 1983, these same four BPCRs broke-out 1,634 parts, resulting in savings estimated at almost $36 million. In FY 1984, they were able to break-out 961 parts, resulting in savings estimated at $152 million.

Congressional confidence in the SBA BPCR Program was manifested during the second session of the 98th Congress by the enactment of H.R. 4209, the "Small Business and Federal Procurement Competition Enhancement Act of 1984" which was signed by the President on October 30, 1984", becoming P.L. 98-577. This statute provided a statutory basis for the BPCR program, defined the BPCR's functions, and authorized the assignment of BPCRs to major Defense Department procurement centers annually purchasing over $150 million in spare parts.

In FY 1985, SBA had BPCRs at 14 DOD procuring activities. They were able to break-out to competition some 1,829 items. The estimated savings from these break-out actions totalled $142.9 million. In FY 1986, SBA had BPCRs at 18 DOD procuring activities. They were able to break-out 1,556 items, with an estimated savings of $171.1 million. SBA's appropriation for FY 1986, contained in Public Law 99-180, funded Breakout Procurement Center Representative Program's at the requested level. For FY 1987, Public Law 99-500 provided funding to place SBA BPCR teams at each of the 31 DOD procurement centers that met the statutory standard set forth in Public Law 98-577.

In the report accompanying the Senate version of H.R. 2965, the FY 1986 SBA Appropriations Act, Senate Report 99-150, SBA was directed to initiate a pilot Systems Procurement Center Representative (SPCR) Program modeled after the successful BPCR Program. The new pilot program's objective would be to expand subcontracting for small firms with major systems acquisitions by the Department of Defense. The fundamental functions of the SPCRs would be to search out, identify, and analyze small business firms and match their capabilities with requirements for research and development, testing and evaluation, full-scale engineering, and component development relating to major systems or subsystems. The objective would be to marry the capabilities of small firms to the needs of large firms likely to compete for a major system or subsystem contract so that the small firms will be included in the large firms' subcontractor teams. The Committee recommended the placement of SPCRs in lieu of BPCRs at Defense Department activities whose principal responsibility is the development and acquisition of major systems or major subsystems. The pilot program calls for the placement of SPCRs at six DOD activities, encompassing all three military services. The direction to initiate the Pilot SBA Systems Procurement Center Representative Program was reiterated in SBA's FY 1987 appropriations act and implementation is expected early in calendar year 1987.

Inquiries into the Results of Competition Advocacy and Spare Parts Breakout Programs

During the 98th Congress, the Committee, in concert with Senate Committees on Governmental Affairs and Armed Services and the counterpart Committees in the House of Representatives, devoted

very substantial energies to both oversight and legislative initiatives in the area of the Federal procurement process, most especially as conducted by the buying activities of the Defense Department. These efforts resulted in the enactment of three major pieces of substantial procurement policy legislation: the "Competition in Contracting Act of 1984", provisions of which are a part of Public Law 98-369; the "Small Business and Federal Procurement Competition Enhancement Act of 1984", Public Law 98-577 and Public Law 98-525 had their origin in S. 2489, the "Small Business Competition Enhancement Act of 1984", a Senate Small Business Committee bill.

All three of these pieces of procurement policy reform legislation are designed to substantially increase the amount of competitive contracting throughout the Federal procurement system by both enunciating basic competitive acquisition policies and attacking specific obstacles standing in the path of competitive procurements. Implementation of all three statutes is well underway. In particular, the Department of Defense seems to be making very substantial efforts to fully institutionalize the changes mandated by the statutes. The Competition Advocacy Program and the Spare Parts Breakout Program being undertaken by each of the Military Services and the Defense Logistics Agency have both received substantial manpower resources and sustained command attention. Both of these programs should be expanding the number of competitive contracting opportunities, a situation which will work to the strong benefit of small business government contractors.

During the 99th Congress, the Committee undertook two oversight activities to determine the results of the Competition Advocacy and Spare Parts Breakout Programs. A field hearing was conducted on March 22, 1986, chaired by Senator Nickles, at the Oklahoma City Air Logistics Center, one of five air logistics centers operated by Air Force Logistics Command (AFLC). The purpose of the hearing was to access the accomplishments of AFLC's Competition Advocacy Programs for Fiscal Years 1984 and 1985 at Oklahoma City Air Logistics Center and throughout the Command. The hearing also looked to the interface between the AFLC Competition Advocacy Program and the SBA's Breakout Procurement Center Representative Program, with an eye to facilitating maximum cooperation toward their common goal. Testimony was received from Brigadier General Richard D. Smith, AFLC's Deputy Chief of Staff for Contracting and Manufacturing, the Competition Advocate at Oklahoma City Air Logistics Center, and the Director of the Center's Office of Small and Disadvantaged Business Utilization. Jesse R. Quigley, the SBA Assistant Regional Administrator for Procurement Assistance for Region VI presented the accomplishments of the SBA Breakout Procurement Center Representative (PBCR) Program within the Region. Frank Miller, the Breakout Procurement Center Representative at Oklahoma City Air Logistics Center focused on the interaction between his BPCR team and the Competitin Advocacy team at the Air Logistics Center. To provide the perspective of the small business government contractor, witnesses representing various segments of the vendor community provided testimony, including manufacturing, professional and technical

services, architect-engineering services, and commercial products suppliers.

During the hearing, extensive testimony was also presented by witnesses representing public, non-profit, and business concerns providing an array of technical assistance services to firms seeking to market to the Federal Government. Of particular note was the description of the extensive services provided by the Federal Marketing Assistance Program operated by the Indiana Department of Commerce.

This highly successful program was one of the early awards of financial assistance made available under the Defense Department's Procurement Technical Assistance Cooperative Agreement Program.

Several witnesses representing major prime contractors presented testimony concerning their small and disadvantaged business subcontracting program. This testimony, complemented the testimony of SBA's witness, which stressed the importance of the Government subcontract market to small firms.

The Committee also requested the General Accounting Office to conduct an analysis of the Defense Department's accomplishments in the implementation of its Replenishment Parts Breakout Program. GAO's report entitled, "Limited Data on DOD's Parts Breakout Program", was issued to the Committee on October 10, 1986. The report's principal was that the Defense Department lacked adequate data to conclusively report on the success of its breakout program and the savings being reported. GAO also made several important suggestions for modifying DOD's breakout regulation which would enhance the likelihood that DOD's breakout efforts would result in increased numbers of competitive contracting opportunities.

Small Business Set-Aside Program

Standard for Small Business Set-asides—the so-called "Rule-of-Two".

The Chairman and Ranking Minority Member of the Committee, who also serve on the Committee on Appropriations, led a successful effort to include a provision in the Senate version of H.R. 5294, the "Treasury, Postal Service and General Government Appropriations Act, 1987", to prevent any changes to the procurement regulation that provides the standard used by an agency contracting officer to determine if a contracting opportunity should be set-aside for exclusive competition among eligible small business concerns. The provision was included in the conference report to H.J. Res. 738, the Omnibus Continuing Resolution for FY 1987, and was signed into law on October 18, 1986, as Section 621 of Public Law 99–500.

Small business government contractors win approximately fifty percent of their Federal contract awards in competitions restricted exclusively to eligible small firms, so-called "small business set-asides" authorized under Section 15(j) of the Small Business Act. The standard used by contracting officers in making the decision as to whether a particular contracting opportunity should be "set-aside" is found in Section 19.502–2 (Total Set-Asides, Set-Asides for

Small Business) of the Federal Acquisition Regulation (FAR). Under the present rule, the so-called "Rule-of-Two", the contracting officer must set-aside a contracting opportunity if there is a reasonable expectation of receiving offers from at least two eligible small business concerns capable of meeting the Government's requirements at reasonable prices.

On May 22, 1986, OMB's Office of Federal Procurement Policy published for public comment in the *Federal Register* a proposed change to the "Rule-of-Two." Most small business government contractors perceived the proposed change as a radical departure from the current standard, which would result in a very substantial decline in the number of contracting opportunities limited to exclusive small business competition.

OMB took the position that their proposed change to the "Rule-of-Two" is required by a provision of the "Competition in Contracting Act of 1984", P.L. 98-369. This position was espoused in correspondence to individual Senators and Representatives. On June 5, 1986, it was confirmed in testimony by OMB's Deputy Director presented to the subcommittee of the House Small Business Committee. Given OMB's position that the proposed regulatory changes were mandated by statute, the relevance and efficacy of public comments opposing the rule were dramatically called into question. It appeared that legislation, clarifying Congressional intent regarding small business procurement set-asides might be required.

Section 621 will provide the Senate and House Committees on Small Business adequate time to review the impact of the proposed regulatory change, consider alternatives, and if need be, to consider appropriate remedial legislation. The provision delays any changes to the current procurement regulation until July 15, 1987.

SBA Certificate of Competency (COC) Program Review

Section 8(b)(7) of the Small Business Act of 1953, (15 U.S.C. 637(b)(7), authorizes the Small Business Administration's (SBA) Certificate of Competency (COC) Program. Under this authority, a small business concern is eligible for an SBA review of its capability to perform a federal procurement contract, its "responsibility" in the terminology of Federal Acquisition Regulation, if it has been found "nonresponsible" by the agency contracting officer and if the small business concern has otherwise been determined to be the prospective awardee of the contract. The COC Program is intended to assure that small business concerns, especially new entrants into the federal procurement market, are afforded a fair opportunity to receive government contracts. This program was established to counteract the perceived bias of some agency contracting officers concerning the ability of small businesses to perform government contracts in a timely fashion in full conformity with specifications. Obviously, the integrity of the program is undermined—and the legitimate interests of the procuring agencies put at risk—if the COC review is conducted in a haphazard or inattentive fashion.

The Federal procuring agencies have long complained about SBA "second guessing" their determination of a prospective contractor's responsibility. During the 99th Congress, the Committee requested the General Accounting Office (GAO) to undertake a comprehen-

sive review of the COC Program. Research by Committee staff found that there has been no comprehensive review of the COC Program in a decade. Only two prior GAO reports could be identified since 1975. One report, issued to the SBA in 1978, looked at the operation of the program in SBA Regions I and II only. The second report was a 1980 letter report to Senator Gaylord Nelson, as Chairman of the Senate Small Business Committee, and Senator Jim Sasser, a Committee Member. It focused on two specific firms that had received COCs. Similarly, Committee staff found that neither the Senate nor the House Small Business Committees have conducted oversight hearings focused on the COC Program, since the mid-1970s.

The purpose of the broad review was to: (1) assess the current performance of the COC Program; (2) identify problems, if any; and (3) recommend changes to the program, if appropriate.

On April 14, 1986, the GAO issued its report, "Status, Operations, and Views of the Certificate of Competency Program." The report sets forth the scope of the COC Program, as follows:

TABLE 3.1.—COC PROGRAM ACTIVITIES FISCAL YEARS 1981–1985 [1]

	Referrals to SBA	Contractor applications [2]	COC approvals	Application denials	Direct awards without a COC
Fiscal year:					
1981	2,652	880	489	322	12
1982	2,837	998	495	409	13
1983	2,949	1,071	556	393	20
1984	3,072	1,099	547	378	29
1985	4,223	1,652	884	540	54
Total	15,733	5,700	2,971	2,042	128

[1] Statistics were compiled by GAO from SBA's computerized management information system.
[2] The number of approvals, direct awards, and denials does not equal the number of applications because of such things as: applications withdrawn, referrals withdrawn, and procurements withdrawn.

When considering the increasing activity within the SBA COC Program, it is important to keep several points in perspective. First, the significant numbers of contract actions referred to the SBA COC Program, in which the small business chooses not to make an application for a COC. Second, the number of COCs actually issued in each year as compared to the number of applications and referrals. And, finally, the overall magnitude of Federal procurement activity in each fiscal year as compared to the number of contract actions that enter the COC Program. In FY 1985, for example, the executive agencies executed slightly more than 21.1 million procurement actions (which includes contract modifications as well as contract awards). Assuming that only 40 percent of these 21.1 million procurement actions are contract award actions, the 4,223 referrals to SBA under the COC Program cannot too easily be considered a major disruption to the overall process. But, at the same time, the program is of vital importance to the individual small business government contractor found to be "non-responsible" by the contracting agency, who makes a COC application, confident that a demonstration of its capability to perform the contract can be made.

At the Committee's request, GAO reviewed the SBA's procedures for evaluating the prospective small business government contractor's capabilities. They found them to be consistent with the standards outlined in the government-wide Federal Acquisition Regulation (FAR) and used by procuring agency personnel in the conduct of pre-award surveys used to determine whether any prospective contractors can be deemed "responsible." The SBA's COC application requirements call for the small business to submit a full array of information relating to financial capacity, personnel, management and quality assurance, production, and performance on prior contracts with the Government.

One of the major findings of the GAO review of the SBA COC Program was that in a vast majority of cases there was a change of factual circumstances between the time the agency personnel found the prospective small business government contractor "non-responsible" after conducting their pre-award survey and time SBA issued its COC after re-evaluating the firm's capabilities. Basically, what the GAO found was that firms making application for a COC were already in the process of taking the actions necessary to correct the deficiencies noted during the agency's pre-award survey. Thus, by the time SBA conducted its review of the firm's capabilities, using essentially the same criteria and procedures, the deficiencies were no longer present. GAO found that "changed circumstances" were involved in 83 percent of the cases sampled during GAO's review.

GAO report did reflect that SBA needed to improve its monitoring of the performance of a firm issued a COC to assure timely completion of the contract in accordance with its specifications and terms. Recommendations were made regarding improvements in the monitoring process.

One of the most interesting features of the review was a survey of agency procurement officers to obtain their opinions concerning the SBA COC Program. When contrasted to the GAO's findings concerning the actual conduct of the COC Program, the survey reflected a generally negative opinion of the program, grounded in "folklore" rather than fact. SBA has taken steps to try to improve the program's image within the contracting community, by more effectively communicating the rigor of the application and review process and dispelling the myth that SBA is merely substituting its judgment for that of the procuring agency.

During the 100th Congress, the Committee will determine whether this GAO report should be the focus of an oversight hearing on the SBA Certificate of Competency Program. Such a hearing would provide the opportunity to recognize the positive "reality" of the Program as contrasted with its negative "mythology", but at the same time identify management improvements which will protect the legitimate interests of the procuring agencies.

SBA Surety Bond Guarantee (SBA) Program Review

Section 411 of the Small Business Investment Act of 1985, as amended, (15 U.S.C. 649b) authorizes the Small Business Administration's (SBA) Surety Bond Guarantee (SBG) Program. Under this program, the SBA agrees to indemnify a surety company providing

bonds (bid bonds, performance bonds, and/or payment bonds) to eligible small business concerns by agreeing to reimburse the company for up to 90 percent of the value of the bond(s) issued to a small business concern in the event that the actions of such small business concern require the surety company to make payment under the bond(s). Small business concerns, especially in the construction field, must obtain such bonds in order to compete for Federal, state or local government contracts as well as private work, since the possession of bonds is mandated by Federal and state statutes, many local ordinances, and private industry practice in most locales. Thus, access to required bonding is essential to small construction firms, whether they are working as prime contractors or subcontractors. Yet, most small firms, due to their thin capitalization and limited experience, often find it difficult to obtain adequate bonding in the marketplace without the SBA guarantee. Since the inception of the SBG program in 1971 through the end of FY 1984, the SBA reports that it has provided guaranteed bonds on more than 166,000 contracts with a total value of about $12.6 billion. For FY 1986, slightly in excess of $1.1 billion in guarantee authority was authorized the maximum guarantee on a contract is $1.5 million. Clearly, the SBG program is an important program to facilitate small business participation in the marketplace, especially the government procurement market.

At the same time, the Small Business Committee has subjected the SBG program to close scrutiny due to some persistent management problems that have been clearly identified, but only slowly remedied. During the 96th Congress, the Committee held two days of oversight hearings on June 30 and September 25, 1980, which focused exclusively on the SBG program. During those hearings, GAO representatives provided important testimony on its review of the SBG program undertaken at the Committee's request. The GAO report, "The Surety Bond Guarantee Program: Significant Changes Are Needed in Its Management" (CED–80–34; December 27, 1979), offered SBA specific recommendations for improvement in the program's management.

During the First Session of the 97th Congress, Committee staff conducted a comprehensive investigation of the SBG program conducted in concert with SBA's Inspector General. On March 11, 1982, the Committee held another day of oversight hearings on the SBG program to present the findings of the investigation and to receive testimony from the Program managers at SBA's central office and representatives of bonding companies participating in the program. During his testimony, SBA's Inspector General chronicled the succession of SBA internal audits of the SBG program since its beginning in 1971. In February 1973, and again in August 1974, SBA auditors reviewed the program's management and determined that the absence of underwriting standards and claims review procedures were fundamental management deficiencies. SBG program officials agreed. In June 1975, another audit of the program resulted in the same findings and recommendations. And, again, the program managers agreed that underwriting standards and claims review procedures were essential to the effective management of the program. The SBA Inspector General went on to recount the identical findings and recommendations resulting from IG reviews

of the SBG program in 1977 and 1981. Five separate audits, resulting in almost identical findings and recommendations, represent a decade of program operation without clear program guidance for the awarding of guarantees or the payment of claims. The SBA Inspector General concluded his testimony with a series of recommendations to improve the program's management.

In light of the foregoing, the Committee requested the General Accounting Office to review SBA regulations, policies, and procedures for management of the Surety Bond Guarantee Program to determine whether SBA has implemented any of the recommendations for improved program management made by the General Accounting Office in its 1979 report (CED-80-34), or by the SBA Inspector General in his testimony to the Senate Small Business Committee during the March 11, 1982 hearing, or any of SBA's own proposed recommendations to improve the SBG program's claims handling procedures, as presented during a hearing conducted by the House Small Business Committee's hearing on May 17, 1983.

The GAO issued its report entitled, "Surety Bond Guarantee Programs: Small Business Administration's Actions on Prior Program Recommendations." (GAO/RCED-86-183BR; 18 September 1986).

The GAO's summary of its findings in the various areas of SBG Program management are as follows:

(1) Program Statistics and SBA's New Management System:

Since 1984, the number and value of contracts guaranteed has increased.

Number and value of claims paid are decreasing.

Program savings to the government are increasing.

Program staff is decreasing.

SBA expects its new computerized information system to be fully operational in December 1986.

(2) Underwriting Guidelines:

SBA has two documents that serve as underwriting guidelines.

According to SBA

its staff does not perform in-depth verification of data in selected applications due to limited staffing and plans for less day-to-day involvement with sureties;

its staff declines applications with outdated, inaccurate, or incomplete data as part of general underwriting practices; and

sureties, not SBA, should take the necessary action to exclude surety agents who repeatedly submit unreliable data.

(3) Claims Review Procedures and Loss Rates:

SBA requires that an itemization of payments accompany a surety's request for reimbursement.

SBA does not think it is practical to develop claims-handling reimbursement rates; SBA's overall concern is a surety's bottom-line loss rate.

SBA's draft proposed program rules allow for reimbursement of reasonable attorney fees, but SBA's overall concern is a surety's bottom-line loss rate.

SBA has implemented, or is in the process of implementing, the majority of claims-handling procedures that it identified in 1983.

SBA developed a procedure to compute a loss ratio comparable to that of industry.

(4) Surety Company Monitoring and the SBA Inspector General's Audits:

SBA has not established written requirements instructing sureties to monitor contractor progress.

The SBA Inspector General has not performed a claims audit since 1981 mainly because of a lack of (1) staff and (2) cost principles to apply during a claims audit.

Oversight of the Prompt Payment Act of 1982—Oversight of the Act's Implementation

Timely payments to Government contractors has always been a very important issue to small firms doing business in the Federal procurement market. Small business government contractors cannot afford the additional costs of having to finance delayed payments from the Government. Such financing costs erode hard won profits and if the delays are lengthy can transfer the contract to the "loss" side of a small company's ledgers.

The Committee on Small Business has been in the forefront of legislative and oversight efforts to assure that small business government contractors are paid in a timely fashion. The Prompt Payment Act of 1982 had its origins as an important initiative of the Small Business Committee during the 97th Congress. Senator Sasser introduced the Late Payment Act of 1981, S. 30, early in the first session. Then, Senator Danforth and Senator Chiles, Chairman and Ranking Minority Member of the Governmental Affairs Committee's Subcommittee on Federal Expenditures, Research and Rules, took up the cause and introduced S. 1131, the "Delinquent Payment Act of 1981" along with 22 original cosponsors, including most Members of the Committee on Small Business.

A companion measure, H.R. 4709, the "Prompt Payment Act" was concurrently moving steadily through the House with the strong support of Representative Jack Brooks and Frank Horton, Chairman and Ranking Minority Member of the Committee on Government Operations and a broad, bipartisan array of their colleagues. S. 1131 was finally signed into law as the "Prompt Payment Act," on May 21, 1982, and became effective on October 1 of that year.

Government contractors, small businesses and large firms, have had four complete fiscal years of experience with agency billpaying practices subject to the Prompt Payment Act's requirements. This experience, closely monitored by the Coalition for Prompt Pay, a broadbased coalition of associations representing small business contractors, as well as large firms, has lead to two basic conclusions. First, that the Prompt Payment Act has improved the Government's billpaying practices; and second, that the agencies have frustrated full implementation of the Act as intended by Congress by exploiting ambiguities and loopholes in the statute.

Given the four years of experience under the Act and the problems being repeatedly faced by small business Government contractors, the Prompt Pay Coalition and its member associations began to call for oversight hearings and consideration of amendments to remedy problems identified. The Committee's National Advisory Council adopted a resolution to that effect on October 25, 1985.

That resolution stated:

Whereas, the members of the National Advisory Council to the Senate Committee on Small Business, having considered the Federal agency implementation of the Prompt Payment Act, Public Law 97-177, during the three years since it became effective on October 1, 1982, have found that the objectives of the legislation and the intent of Congress are not being fully attained;

Whereas, some Federal agencies continue to make payments beyond the payment date specified in its contracts or beyond, the times specified in the Act, without the payment of interest;

Whereas, some Federal agencies are abusing the fifteen day "grace period" provided in the Act by failing to initiate payment action or contractors' invoices until the expiration of thirty days;

Whereas, some Federal agencies are delaying payments to small business contractors by rejecting their invoices as "improper" after the fifteen days provided by the Act;

Whereas, some Federal agencies are delaying payments to small business contractors by refusing formal acceptance of supplies, services or construction so as to delay the start of the payment periods mandated by the Act, after which interest must be paid;

Whereas, some Federal agencies are failing to automatically pay interest due to small business contractors, rather requiring them to make a demand for payment of interest contrary to the Act's self-enforcing intent;

Whereas, these problems with agency implementation of the Act are placing substantial financing burdens on small business government contractors, and acting as an obstacle to small business participation in the Federal procurement market, thus denying the Government the advantages of the competition, industry, and innovation provided by many small businesses;

Therefore, be it resolved that, the National Advisory Council to the Senate Committee on Small Business calls upon the Congress, especially the Senate and House Committees on Small Business, the Senate Governmental Affairs Committee, and the House Government Operations Committee which were instrumental in the pasage of the Prompt Payment Act, to:

1. conduct oversight hearings on the implementation of the Prompt Payment Act through OMB Circular A-125, the Federal Acquisition Regulation, and the implementing regulations of individual Federal agencies; and

2. to consider modifications to the Prompt Payment Act that will address demonstrated implementation abuses by some Federal agencies and assure attainment of Congressional intent and objectives in passing the Act.

The issue of implementational problems regarding the Prompt Payment Act was also raised by many small business owners during the state and regional meeting that preceded the White House Conference on Small Business, which was held August 17–21, 1986. A resolution calling for vigorous enforcement of the Act and suggesting a series of amendments was voted as Recommendation No. 32 from a starting Conference issue agenda of over 400 issue items.

Final Recommendation No. 32 of the 1986 White House Conference on Small Business, reads:

> Prompt pay legislation should be extended to cover postal service and federally assisted procurement and strengthened through an amendment to the 1982 Prompt Payment Act to eliminate the fifteen day grace period; require automatic payment of interest penalties; more clearly define that the entire payment process, including acceptance, must occur within 30 days; include progress payments and retainage; and require prime contractors to pay their sub-contractors within seven days after receiving payment from the government or incur interest payment penalties. In addition, when the government pays the prime contractors late, interest payments shall flow through from prime contractors to sub-contractors on a pro-rata basis. The prompt payment act shall be vigorously enforced by all branches of government.

Given the strong small business call for oversight, the Committee took the lead under the leadership of Senator Paul Trible, the Committee's newest Member. On December 2, 1985, Senator Trible chaired a Small Business Committee field hearing in Norfolk, Va. Representatives of small firms providing supplies, an array of services, and construction to various Government agencies provided testimony. A very extensive statement was presented by the Prompt Pay Coalition. The testimony expressed three basic themes. First, the Prompt Payment Act has substantially improved the bill paying practices of those executive agencies which are subject to its provisions. Second, many agencies have devised various stratagems, based on ambiguities in the act, which have permitted them to pay late without incurring late payment interest penalties, principally by delaying the start of the payment clock. Third, agency implementing regulations have restricted the act's application, and thus its protections, with regard to certain types of payments due to contractors, most notably, construction progress payments, and partial and periodic payments under supply and service contracts. Agency testimony was received from Navy personnel representing Defense agency experience and GSA representatives on behalf of the civil agencies.

S. 2479, the Prompt Payment Amendments of 1986

After a careful consideration of this extensive hearing record, additional materials submitted to the Committee by individual contractors and the associations comprising the Prompt Pay Coalition, as well as OMB's reports to the Congress on agency performance

under the Prompt Payment Act for Fiscal Years 1982, 1983, and 1984, Senator Trible directed committee staff in the preparation of what became the "Prompt Payment Amendments of 1986." Extensive informal staff discussions preceded the bill. These discussions involved not only groups representing small business Government contractors but individuals within OMB's financial management division. A discussion draft was widely circulated for comment. Copies were provided to OMB, as well as the General Accounting Office (GAO) task force conducting a review of Representative Jack Brooks in his capacity as Chairman of the Legislation and National Security Subcommittee of the House Government Operations Committee.

On May 21, 1986, Senator Trible introduced the "Prompt Payment Amendments of 1986," which became S. 2479. He was joined by 20 original cosponsors including most of the Members of the Small Business Committee and many of the key sponsors of the original Prompt Payment Act legislation, including Senators Danforth and Chiles.

A full Committee hearing on the implementation of the Prompt Payment Act was held on June 19, 1986. At this all-day hearing, which was chaired by Senator Trible, extensive testimony was received from 13 witnesses, principally representing small business Government contractors. Many additional statements were submitted for the record.

Testimony was presented on behalf of the Prompt Pay Coalition, the National Federation of Independent Business (NFIB), the Small Business Legislative Council (SBLC), the Associated General Contractors of America (AGC), the American Subcontracting Association (ASA), and others. Most of their testimony followed the themes of the previous field hearing, but expanded to a national scope. Especially useful testimony comparing the objectives of the Prompt Payment Act and agency implementation during the first 3 years was presented by Christopher R. Brewster, who served as staff director to the former Subcommittee on Federal Expenditures, Research and Rules at the time S. 1130 was considered and enacted.

John J. Lordan, OMB's Deputy Associate Director for Financial Management presented a statement from James C. Miller, III, Director of the Office of Management and Budget. Although not a legislative hearing, most of the witnesses, including the OMB representative, commented on S. 2479. All of the private sector witnesses supported the bill. OMB's testimony acknowledged that the bill addressed valid implementational problems. However, as expected, OMB opposed a legislaitve solution, preferring to make the necessary improvements through amendments to OMB Circular A-125 (prompt payment), the issuance of appropriate implementing procurment regulations in the Federal Acquisition Regulation (FAR), and other adminstrative actions.

The full Committee hearing did develop one new issue of substantial significance: whether the Prompt Payment Act should be amended to provide protection to subcontractors under Federal construction contracts. Testimony from the witnesses representing ASA and the Associated Specialty Contractors (ASC) addressed this issue extensively, strongly urging such an amendment to the act. Support for such an amendment was also included in the testimony

of the witnesses representing the Prompt Pay Coalition, NFIB, and SBLC. AGC's witness opposed such an amendment on the basis that it would be an unwarranted governmental intrusion into what is essentially a private contractual relationship between the prime contractor and its subcontractors. As a fundamental policy, AGC opposes any governmental intrusion on the principle of privity of contract.

Jurisdiction for the Prompt Payment Act, and thus S. 2479, resides with the Committee on Governmental Affairs and its Subcommittee on the Oversight of Government Management. Given the 623 pages of printed hearing records compiled by the Small Business Committee, the Oversight of Government Management Subcommittee, chaired by Senator William Cohen, was able to proceed directly to mark-up. S. 2479 was reported by the Subcommittee on August 14, 1986.

During mark-up, the Subcommittee added a provision to the bill, Section 7 (Payment Clause for Subcontracts Under Construction Contracts) extending the protections of the Prompt Payment Act to subcontractors on Federal construction projects through the "four corners" of their subcontract agreement by establishing minimum standards for the payment provision between a prime contractor and its subcontractors. S. 2479 was reported by the full Committee on Governmental Affairs on October 2, 1986. It was passed by the Senate on October 15, 1986 by unanimous consent vote. At the time of passage, S. 2479 has 44 cosponsors.

The House of Representatives, and its Committee on Government Operations, chose not to act on S. 2479 in the closing days of the 99th Congress. As a result of a hearing held on July 29, 1986, before the Legislation and National Security Subcommittee on the House Government Operations Committee, Chairman Jack Brooks wanted to provide time to the Administration to administratively correct as many of the problems identified in the testimony presented by the witnesses representing small business government contractors and in the August 28, 1986 report of the General Accounting Office, entitled "Prompt Payment Act—Agencies Have Not Fully Achieved Available Benefits."

Further action on oversight of the Prompt Payment Act and needed amendments can be expected early in the 100th Congress by both the Senate and the House. The Committee on Small Business will again be in the forefront of this effort.

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